

RECORD COPY

F. M. U.  
Occasional Lectures  
1

# The Budget as an Instrument of Administrative Efficiency

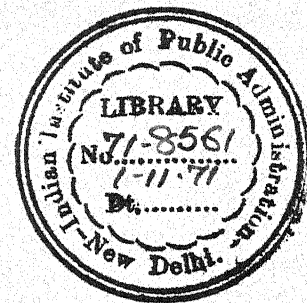
Prof. GUNNAR HECKSCHER

Former Swedish Ambassador in India

IIPA LIBRARY



8561



INDIAN INSTITUTE OF PUBLIC ADMINISTRATION  
INDRAPRASTHA ESTATE, RING ROAD, NEW DELHI

SEPTEMBER 1971

PRICE : INDIA : RS. 6.00  
ABROAD : \$ 2  
95 P.

## PREFACE

It is not customary to write prefaces to occasional lectures published by the Institute. The departure from custom is warranted by the fact that public lectures on budgetary and financial matters have been rare. Secondly, even though a series of public lectures on these matters had been arranged in the Institute in 1966, the lectures could not be published till now. The Financial Management Unit came into being only in 1969 and I am glad to say it is assuming its role gradually.

With growing interest in training and research in the field of financial management, the need is being felt for more literature on the subject of budgeting and financial management. It has therefore been decided to publish "The Occasional Lectures" in a serial form. In this series the two lectures given by Professor Gunnar E. Heckscher are published in this volume.

NEW DELHI  
DECEMBER 15, 1970

J. N. KHOSLA  
*Director*  
INDIAN INSTITUTE OF PUBLIC  
ADMINISTRATION

## INTRODUCTION

The role of Budget as an instrument of policy and decision-making is being realised to a greater extent with the advent of planning in this country. It forces the executive to think ahead and to think deeply with a view to committing his resources of men, materials and money to future tasks. A good deal of literature is available on the topic of budgeting which serious students of Financial Management are aware of.

“The Budget as an instrument of administrative efficiency” is a profound theme, which has to be appreciated in the context of different constitutional and legislative set-up in different countries. Professor Gunnar Heckscher, former Swedish Ambassador in India has been associated with the universities of Uppsala and Stockholm as Professor of Political Science. He has been the Chancellor of Stockholm Institute of Social Sciences, Leader of the Conservative Party in Sweden, served as an expert in the United Nations and has many books to his credit. His treatment of the subject of budget as an instrument of administrative efficiency therefore, has the backing of a varied experience. Objective budgeting gives the spending agencies freedom of choice in the details of executing the budgeted funds and therefore it makes their work flexible and efficient. On the other hand in subjective budgeting the services are provided for the types of expenditure without much relation to the particular objectives. As an example of the difference in the two types of budgeting Dr. Heckscher has cited the case of a dictaphone. With the dictaphone, typists with less experience and training can be utilised. It is only the initial investment that is to be settled. The recourse to a dictaphone can be had when skilled stenographers are not available. The availability or otherwise

of skilled stenographers at any given point of time cannot be conceived of in advance when the budget is formulated. The decision is to be taken only when the need actually arises and when it is found that the men previously employed are inadequate to gain the purpose in view.

He views objective budgeting as comprehending performance budgeting and he recommends this as an ideal in a comparatively smaller organisation where the leadership can exercise far-going control over its own administration. As an example of objective budgeting at government level Prof. Heckscher has cited the case of the Netherlands.

It is hoped that officials both in public and private sector and in government, and students of financial management will find the lectures interesting and illuminating.

Ambassador Heckscher has been good enough to go through the manuscript and we are indebted to him for this ready help.

I wish to acknowledge the assistance rendered by Shri K. B. Iyer, Training Associate of Financial Management Unit of the Institute in editing the lectures.

NEW DELHI  
DECEMBER 1, 1970

M. J. K. THAVARAJ

## CONTENTS

	PAGE
PREFACE ... ..	v
INTRODUCTION ... ..	vii
THE BUDGET AS AN INSTRUMENT OF ADMINISTRATIVE EFFICIENCY—I ... ..	1
THE BUDGET AS AN INSTRUMENT OF ADMINISTRATIVE EFFICIENCY—II ... ..	23
APPENDIX	
WORKING PAPER ON THE PRINCIPLES OF PERFORMANCE BUDGETING ... ..	46



# THE BUDGET AS AN INSTRUMENT OF ADMINISTRATIVE EFFICIENCY—I

## Subjective and Objective Budgeting

*By*

**Prof. Gunnar Heckscher**

(Former Swedish Ambassador in India)

*Dr. Khosla* (Director IIPA): Friends, it is for me a very real pleasure to welcome His Excellency the Swedish Ambassador. You might have noticed downstairs, and that was done without my knowledge, that the name announced was Prof. Heckscher. It is as a professor that I would like most of us to welcome him to this Institute. I have the privilege of having known him since 1951 when I visited Sweden at the invitation of the Swedish Political Science Association to deliver a series of lectures at two or three centres there.

His distinguished career is well known to you all and I am sure the Chairman today will say something about that.

But personally, I feel the Institute is lucky to bring in experience of this kind.

I am happy that we were able to get Mr. K. B. Mathur to be the Chairman for this lecture. He does not need any introduction. He has presided over such lectures before as the Chairman of the Railway Board, as Chairman of the Heavy Electricals and so many other public undertakings. He has had a remarkable record and has had to deal with some of the problems that would be raised in Prof. Heckscher's lecture today.

I thank you all for having come. I extend a hearty welcome to you.

*Mr. K. B. Mathur* (Chairman): Friends, I have great pleasure in introducing to you this evening's lecturer, His Excellency Prof. Gunnar Heckscher. I have not had the pleasure

previously of knowing our distinguished lecturer. He is a political scientist who has taught for many years with great distinction political science and public administration in Sweden. He joined the U.N.O. service in 1952 or 1953, to set up an Institute of Public Administration in Turkey. He was also the Vice-President of the International Political Science Association and then later, he joined the Swedish Parliament and was the leader of the Conservative Party.

His topic today is "Budget as an Instrument of Administrative Efficiency".

*Prof. Gunnar Heckscher* : Mr. Chairman, Dr. Khosla and Gentlemen: May I say first that I am very happy to be introduced in this way, particularly when I see Dr. Khosla here near me. I am pushed back about 15 years in time when he was in Sweden giving lectures and taking sometimes part, I think, in seminar discussions. I now reciprocate it. He is now the academic person and I am the civil servant. In those days it was the other way round. Well, I think we have these experiences in common. We have found that there is very much which the civil servants and the students of political science and public administration have in common, and we still have reason to discuss with each other.

When my friend, Dr. Khosla, asked me to come here I chose this subject, partly because it is one where I have done some research and partly because of its increasing importance. My research on a project which I started some years ago was based on a study of budgeting procedures and budget structures in a number of western countries: the U.K., the U.S.A., France, the Netherlands and Sweden. It did not include India nor any other country in this region. I must say that my knowledge of budgeting in this part of the world is very limited indeed.

The choice of countries when I started that piece of research was based on the idea that I wanted to have countries with different constitutional set-up: on the one hand, the U.K. with its long tradition of parliamentary government, where for hundreds of years the executive and the legislative branch had been, as it were, combined, if not united. At the other extreme, the United States of America, where there is still a very real division of power between the executive and the legislative arm:

and then, countries like France, the Netherlands and Sweden, where to a varying degree, traditions based on division of power had been maintained in a system of parliamentary government.

There are certain things I should like to emphasise before I go into the subject matter.

In the first place, the limitations of what I am talking about. I am not talking about the budget as a political instrument. That, of course, was historically extremely important. The budget was a means for the parliament exercising power over the executive. The power of the purse, as it was called in the 17th century Britain, was perhaps the most important of all parliamentary powers. This is in most countries a thing of the past, though certain things of this type still remain. Even where we have parliamentary government, the budget procedures give an opportunity for Members of Parliament to influence political developments in a way rather different from and more general than what they get in ordinary legislation. But I am leaving that out here. I am not going into that constitutional aspect of the problem.

Secondly, I am not going into the economic aspects of the problem. The budget is today seen, perhaps chiefly, as an instrument of economic policy, notably of cyclical policy, and I think that sometimes this aspect has been emphasised to the exclusion of the constitutional and political aspects of budget procedures. But I am leaving them out here because it would lead us too far afield if we were to go into those problems.

Now, if you look at the budget, and this is the third reservation, as an instrument of administrative efficiency, the part of the budget which is particularly important is the expenditure side. The revenue side is of a different character. The revenue side is more closely related to the purely economic, historical and constitutional aspects. But on the administrative side, it is chiefly the expenditure part of the budget which is important. Therefore, I am going to concentrate chiefly on that part.

Since I chose the subject, I got a copy from Dr. Thavaarj of his paper\* on Performance Budgeting. I am not going to go into any detail with regard to that paper. All I can say

---

\*An abbreviated version of the paper may be seen in Appendix.

today is that I am going to attempt to avoid overlapping, as far as possible, since I realize that Dr. Thavaraj's paper has been distributed to you.

Finally, I would like in reference to his paper to add one note on terminology. He uses in his paper the term "performance budgeting". Now I realize that he uses the word in the sense that it is most usually employed. My terminology is slightly different. I would like to distinguish in this respect between what I call subjective and objective budgeting. By subjective budgeting I mean budgeting based on distinction, let us say, between personnel, equipment, current expenses, etc., of any given Ministry or agency employed for a number of purposes. By objective budgeting I mean more or less what he understands by performance budgeting, that is a system where the budget is split up with reference to particular projects or objectives and no clear distinction is made with regard to the means employed in each particular case. I shall come back to this terminological distinction, because in my terminology the word 'performance budgeting' is used to indicate something even more specific than what I am here calling objective budgeting. This, however, will chiefly be a matter for my next talk. It is always a mistake anyway to agree to give two lectures, because the division between the two always presents something of a problem. But I am going to try today to give a descriptive, largely a comparative statement, of budgetary structures and procedures, and then tomorrow I shall go into the problems of how these procedures can be changed so as to facilitate the development of administrative efficiency. That is to say the descriptive, the more tedious part is for today, and the more controversial parts are for tomorrow.

I think it is necessary to begin by reminding you of something which you all know, namely, the very long procedures which go into the establishment, execution and control of a budget. It all, of course, begins with the demands which are made by specific sections of Ministries and/or independent administrative agencies. These demands are related to what the agencies or rather, the sections or the persons working there think is necessary from the point of view of their future work. And these demands are very different in character. Sometimes they are reduced to an absolute minimum in the

opinion of the person making the demands. Sometimes they are presented with a margin because the people presenting these demands know from experience that they won't get what they ask for, and therefore, they ask for a little more than they need to in the hope of getting, after the cuts, what they actually require. This is a difference which is largely temperamental, but the differences in the shape of the demands are important, and it is necessary, therefore, not to make simple percentage cuts in the demands presented, but to go in some detail into the arguments in favour of certain demands. And this is done first in the substantive spending Ministry which screens the demands coming in from different sections and specific administrative agencies.

In the system of my country, which is one of very far-going functional decentralisation, the demands are presented almost exclusively by independent administrative agencies and are then concentrated in a given ministry. Under the system, the Ministry is only a coordinating and not the actual spending agency. But this is very unusual. In most cases, the Ministry is both the spending and the coordinating agency, and the whole work takes place inside the Ministry. The various sections present their demands and then they are screened centrally by some budget section or financial section of the Ministry in question, and there unavoidably, of course, the original demands are cut down because it is found when they are added up that they reach figures which are obviously unrealistic. So even the spending ministry will reduce the demands and will have to go, therefore, into some detail in studying these demands and the arguments advanced before they can present what, to them appears as the necessary minimum.

Then you come to the next stage, where all the requests from the various Ministries have come in; you will again find, almost invariably, that the total figure is absolutely impossible. It is necessary for reasons of economy and for financial reasons and also for political reasons to reduce these figures drastically in order not to allow the budget as a whole to grow beyond reasonable expectations. And here, of course, in the coordination and the cuts done by the Finance Ministry, and sometime also by the Cabinet, or some corresponding

agency—in the United States it is done by the President and the Bureau of the Budget—you also have to go into substantive details. It is impossible to say that you will cut expenditure in all Ministries by 25 per cent or 50 per cent as it is, because, again for various reasons, it may be necessary to give priority to one particular field of public activity and also some ministries are by nature more careful than others in presenting their budget demands. I am emphasising these things to make it quite clear that these three stages—original demand, screening of the spending ministry and the coordination by the Finance Ministry—all of them require considerable amount of time. None of them gets done from one day to another. All of them require careful study—and study not only of the financial situation, but also of the administrative and political necessities involved in the presentation of budget figures.

The next stage, of course, comes when the budget as such—and here again I am speaking of the expenditure side—is presented to Parliament. The scrutiny in Parliament can be more or less detailed. In some countries, such as the U.K. and France today, the parliamentary scrutiny of budget proposals is very general in character. It does not go into any detail. There is discussion, but there is no detailed study of the particular figures on presentation. In other countries, such as the United States and also Sweden, and to some extent even the Netherlands, Parliament repeats a considerable amount of the work which has been done previously, both by the Finance Ministry coordinating the demands of the spending ministries, and by each spending ministry. And in those cases, it also may happen more or less frequently, in the United States actually it is rather frequent, that the parliamentary agency, the parliamentary committees and other organs of Parliament will not only discuss but also make substantial changes in the budget proposals in the form not only of reducing demands to a lower figure, but sometimes also increasing them. In the United States, as a matter of fact, this is a very common occurrence. Congress, both the Senate and the House of Representatives, reduce sometimes by as much as 20 to 25 per cent the demands of the executive, but they may also decide to make increases on specific demands presented to them. This is very often under the influence of local or communal interests, which require a

particular field to be given a higher priority than proposed by the Government. This was formerly usual in many other countries also. It was usual in France, when this practice sometimes went so far as to upset the whole budget structure. Today, it has been made impossible in France on the basis of a practice which was introduced, as a matter of fact, in the U.K. a long time ago, and that is by precluding parliament from making increases. Parliament may reduce, but may not increase the appropriations asked for by the Government. Here, therefore, there are very considerable differences. You may say that in the practice which is employed in the U.K. and France, largely also in the Netherlands and Sweden, the executive arm is responsible for the budgetary structure as a whole, whereas under the American system, formerly employed in other countries also, the responsibility rests with the legislature and the government may at the end find itself confronted with a budget which is not of its own making and which it may find some difficulty in executing in a reasonable manner.

Again, of course, if this parliamentary scrutiny is to be of any value and importance, it takes a considerable amount of time. Thus from the beginning when the demands have been presented by the various sections and agencies to the spending ministries, and to the moment when the budget is actually approved in Parliament, quite a long period has passed, sometimes over a year, which means that the original assumptions on which the demands were based may have changed out of all recognition by the time the budget has been approved. This time-lag may cause a need for supplementary budgets, and supplementary budgets are rather common practice in some countries. In my own country, Sweden, we have sometimes as many as three supplementary budgets in a year, and normally at least two. In France there is usually one and in other countries different procedures are being used. You may not always have technically a whole supplementary budget, but there are always means of rectifying the original figures on the basis of new occurrences.

After the budget has been approved, there still remain three stages: the execution, the accounting and the audit stage. The execution of the budget, again, is something which in



most countries takes place in cooperation between the spending ministries and their agencies and sections on one hand and the Finance Ministry on the other. The extent to which the Finance Ministry is involved in the execution of the budget varies very much from one country to another. There are countries, such as France, where the Finance Ministry follows in detail the execution of the budget at every particular point. There are other countries, such as Sweden, where not only the spending ministries but even the independent administrative agencies are supposed to be free to use the money appropriated—in accordance with the rules laid down—wholly on their own responsibility and without any cooperation from the Finance Ministry.

The next stage is that of accounting, and here again the time problem comes in. Accounting in a private enterprise is one of the most important instruments for following economic developments. But in public budgeting, accounting usually—I would almost say very frequently—lags behind to such an extent that it is almost impossible to follow what is happening, how the money is being spent and how it is being used until it is too late to make any changes. Accounting is sometimes done by the spending ministries alone: sometimes by the Finance Ministry or some specific accounting agency, sometimes doubly, both by one and by the other.

Finally comes the stage of auditing, checking of whether the money has been used in accordance with the rules and procedures laid down.

It should be noted that budgeting itself, that is the screening of demands by substantive ministries, by the Finance Ministry and by Parliament, provides important opportunities for discussing the past execution of the budget. Quite frequently, if the execution has been faulty, this will have an effect on the possibility of the administering agency in question to have its demands acceded to on future occasions. This is true, of course, when it comes to appropriations which recur year after year; but it is true also to some extent, at least, with regard to appropriations which appear only for a very limited period of time. It is a question of the confidence which the Ministry or agency in question inspires with the Finance Ministry, with the financial sections of the spending ministry

and with Parliament. And this will have a very considerable influence on future possibilities. I think anybody who has been practically involved in budgeting, whether in Parliament or in administrative agencies, will know that some ministries and some agencies normally get exactly or almost exactly what they ask for because they are known to be careful in their financial administration. Others will have their demands cut down, frequently in quite an arbitrary way, simply because they do not command the respect of the deciding authorities.

I shall pass very quickly over one aspect, namely, the legal character of the budget. Normally the budget is a law, finance law or budget law, whatever it is called. I think my own country, Sweden, is the only known exception to that. In our system the budget is not a law. It has quite a different character constitutionally. I think that the fact that in most countries the budget is a law is not only a technical device, but it has some relevance also from a constitutional point of view, and it may even in certain very rare cases give the courts jurisdiction over problems arising out of the budget. This, however, does not happen very often, and in most countries particular procedures are found to prevent the ordinary courts from interfering in matters of this kind.

There is another matter, however, which is important and creates difficulties. That is the fact that the budget for practical reasons has to be adopted for a given period of time. Normally the budget is adopted for one year. In only one of the countries which I have studied, namely, the Netherlands, is there a constitutional provision for biennial budgets. However, even there, this provision has never been applied in practice. Invariably the budget is adopted for one year only. This, of course, is a purely artificial arrangement. The work which is being done under the budget, and the financial calculations which are necessary for the budget, normally cover a much longer period of time than one year. The appropriations which are granted in one year may constitutionally or at least practically have an effect far beyond the year for which they have been approved and also the expenditure is, of course, not evenly distributed over the year.

There are, therefore, in many countries today specific devices to facilitate long-term planning of both expenditure



and revenue. You do it with regard to—and here I would like to enter the Indian scene—a very considerable part of your investments through the five year plans. This is a procedure which is not employed in the same way in any other country which I have studied. But you will always find some means of explaining to what extent a given expenditure is binding for a long-term future or adopted only for a limited period of time. This would, of course, present particular problems in budget making, and often budget-makers will tend to minimise the binding character of a given appropriation. They will try to indicate that the appropriation is for one year only, whereas in fact it creates a situation where it is almost inevitable not only to repeat the appropriation given, but sometimes also to increase it very considerably in future periods.

Now there are a number of other structural problems which we cannot by-pass. There is the distinction between the current and investment budgets, or what you here call revenue and capital budget. Another term frequently used is budgeting above and below the line.

As a matter of fact, this is a very difficult distinction. In a great number of cases, the distinction is arbitrary. Something may be put down as investment, whereas in actual fact it is current expenditure although distributed over a longer period of time than the budget year itself. To give one instance of this: military equipment for the armed forces is normally noted down in the budget as investment although it is, in fact, not only a recurring but actually a current expense, and it will then be necessary for various reasons to introduce some writing off procedure so as not to give to this so called investment a character which is unrealistic. Sometimes, also, current expenditure is being used for smaller investments, and in many cases this is a practical and normal procedure. Consequently, the distinction between what you here call, like ourselves, the capital budget and the current or revenue budget is on the whole rather arbitrary. Various items may be moving back and forth between the capital budget and the actual current budget, according to the political exigencies of the day, or according to the ideas of the Finance Minister or his officials at any particular time. This, of course, has its effects on

the economic side. It is related to the question whether the budget should be financed wholly with current revenues or to what extent it should be financed by borrowing. As a matter of fact, the tendency is in certain circumstances to reduce the figures given to the capital budget so as to have a reason for financing more out of current revenues and taxes. In other circumstances, you do exactly the reverse, again to counter the effect which is desired on the revenue side.

There is another point, perhaps not so important and not so much discussed, where also the revenue side and the expenditure side are closely correlated, and that is the question of net versus gross budgeting. There is today in every administration a considerable number of cases where revenues are contingent on expenditure, for instance for services rendered. And normally, not always, where there is gross budgeting, this means that the figure put down for expenditure is unrelated to the revenues. There may be disadvantages in this. It may sometimes be that the administrative agency in question does not take sufficient interest in collecting revenues since they know that whether or not they collect these revenues their expenditure will be unchanged. There is also sometimes a situation where it would actually be more economical for the Government to spend more if the corresponding revenues would increase more quickly than the expenditure, and these developments may be retarded by the fact that this is not possible under the budget.

There is another question of long-term expenditures. How does the budgeting provide for long-term expenditures? Here again, there are very considerable differences. There are some countries where there is no division, where simply what is going to be spent in one year is budgeted for that year regardless of what is going to happen in subsequent years. And if it is not used in the year covered by the budget in question, then the appropriation will lapse and a new appropriation will have to be made in the following year. I know some countries, which are not the subject of my study, where there is no provision for these long-term expenditures at all. We have in Sweden a rather curious arrangement with what we call reserved items. There are certain items in the budget where it is stated that if the money is not used this year, it can be reserved for the next or the year after, but usually not later than that. In the

presentation of the budget, usually the total estimated cost is stated as well as the expected distribution over several years, but technically Parliament will decide only on the grant for the year in question.

The other extreme is the system sometimes employed in United States, where the whole of the obligated expenditure has to be covered in the budget for the year when the expenditure is to begin. This system does not always work out very favourably, if it is a question of expenditure which covers, let us say, four or five years, and there will have to be rectifications practically in every subsequent year as the estimates are being modified. This system is to some extent employed in France also, where obligated expenditure has to be approved to get parliamentary approval, at once and for the whole sum in question.

There is another type of expenditure which is partially unpredictable, where it is practically impossible to say how much will be needed: for instance, cases where the State is legally bound to spend under certain laws. For instance, where the law says—that is true largely in social legislation—that if a citizen finds himself in a certain difficult position, he is entitled to certain grant from the Government, let us say unemployment allowances, it is impossible to say in advance exactly what will be the sum total of the money required for unemployment allowances as long as you cannot predict exactly what the unemployment figure is going to be. And even in certain other cases, such as old age pensions and child allowances, where it is more easy to predict a situation, a certain latitude is required. There may be more children born in a year than expected. There may be more old people surviving than expected. In those cases also, the State is legally bound to spend the money provided a given contingency arises. Now this again is met by different methods. In some countries, such as the United States, it is necessary in this case to pass a supplementary appropriation. In other cases, again such as my own country, certain items in the budget, particularly those which are regulated by legislation, are given a special status. They are called "provisional items" and it is up to the authorities to spend more or less as the case may be. While that is so, there is again the danger that the budget figures may prove unrealistic.

It may happen that figures of this type prove wrong to 5, 10, 15 or 20 per cent even with regard to rather large expenditures, and even in cases where it should have been possible to make better predictions.

Two more things with regard to actual budgeting! In some countries, such as the U.K. and France, different procedures are used for new items which are more carefully scrutinised, and for recurring items where scrutiny is superficial and sometimes hardly takes place at all. I am in doubt as to whether this is a wise procedure. There is sometime a danger that these recurring items will remain so without much change, even where there would be reason either to strike them out or to change them drastically. On the other hand, it is obvious that a new item will always require much more careful argument before it is adopted.

Finally, there is the question of directives attached to the appropriations. Budgeting authorities may decide that money is to be used up to a given figure but only according to certain specific rules and regulations. In many countries these directives are adopted not only by administrative and ministerial agencies but by parliament itself. Parliament will say, for instance, that they grant such and such money for a school of public administration, provided the curriculum is made up according to certain principles—otherwise the money cannot be used at all. This is another of the points where sometimes difficulties will be quite serious because of the time-lag between the original decision and the actual execution of the budget. There may, for instance, be compelling reasons for changing the curriculum on the basis of developments which have taken place after the budgetary decisions were taken.

Before I finish today, I should like to add a few words also about accounting and auditing.

As to accounting, there is, as I said in the beginning, a difference between the cases where accounting is done centrally and where it is done by the spending agencies themselves. Particularly in the former case, where there is central accounting, there is this difference between the public authority and private enterprise that the accounts do not give the necessary information for future activities, because they come in too late. In private enterprise, it is always possible at a given moment

to call for the accounts for a certain type of expenditure to see how this has been working, and even to make lightening changes in the budget in the light of experience which has been gained in that way. This is rarely possible in a public agency, and it is certainly never possible except where accounting is done by the spending agency or ministry itself. The time-lag between execution and auditing, or even the time-lag between budgeting and accounting, is indeed a serious difficulty. The correlation between execution, past execution and former budgeting is also made more difficult in view of the fact that accounts are not yet available. When the budget, let us say, for 1966-67 is presented, even the accounts for 1964-65 may not be available, and certainly accounts for the previous year 1965-66 can obviously not be available at all. And this makes calculations rather difficult in the future. This is again one of the points which seem to indicate that a more flexible system of budgeting than was employed would be needed.

Auditing in a way lies outside the scope of budgeting. But I think it is necessary all the same to say a few words about it, particularly about the objectives of audit. What is the reason for an audit? What do we need it for? Well, the obvious answer is that audit is necessary to safeguard honesty and reliability. This is true in private enterprises. It is, of course, equally true in public administration. There has to be audit to prevent misappropriation and other malpractices in financial administration. But actually this is by no means the only, perhaps not even the most important objective of audit in public administration. In the first place, and this is the aspect which is really given importance in most administrative systems, the audit in public administration, as distinct from the audit in private enterprise, is very much concerned with the legality of the expenditure in question. There may be a situation where the money has been honestly spent, where there has been no maladministration from the point of view, let us say, of economic interest, but where the money has been spent for a purpose which was not approved. There the spending of the money is illegal, although no dishonesty may be involved.

Next, there is the question of economy. It is essential to check expenditure which are unnecessary even though the

expenditure may be perfectly honest, perfectly legal, but is all the same utterly useless, or at least excessive in view of what is gained by spending money. This is the case where things are bought at unreasonable cost.

Finally, there is the question of the efficiency—what is called in private enterprise productivity—of the expenditure which is taking place. Now I think it may be said that the first three aspects, those of honesty, legality and economy, are normally quite well safeguarded by the auditing systems which are employed in public administration in our different countries, at least in the countries with which I am conversant. But the fourth, the question of efficiency and productivity, which plays a very great part in the audit of private enterprise, is not taken equal care of by the auditing system in public administration. And this becomes particularly serious in view of the fact that public administration is dealing more and more with economically important activities. At the same time, it should be remembered that it is indeed much more difficult to check efficiency and productivity in most parts of public administration than in private enterprise. The input-output relation is by no means obvious when it comes to, let us say, military arrangements or diplomatic administration, or administration of the law, or police, etc. It is very difficult to calculate in figures the input-output relations, and at the same time it is quite obvious that even the police may be more or less productive and that even in the case of appropriations for a purpose such as that it is necessary to keep the productivity aspect before our eyes.

There is a thing which happens in most of our countries, which is called "economy drive". At a given moment public opinion requires that public expenditure should be reduced and there is an economy drive. In Britain in the period between the wars, in the 1920's—some people may remember the name of Sir Eric Geddes and the so-called Geddes axe which was set to the British administration and which no doubt affected administration in India as well as in other parts of the world. I have seen to some extent in my own country how these "economy drives" work, and I found they are normally very effective when it comes to small items of expenditure, but totally ineffective when it comes to the

larger items. The reason is quite simple. Economy in the sense in which the word is taken here is quite easily achieved when it comes, for example, to asking people to write on both sides of the paper instead of only one side of the paper; or of using a cheaper type of ink or using a typewriter for a longer time than before. But it becomes virtually impossible when it comes to old age pensions or military equipment or things of that sort, and it is quite obvious from the analyses of any budget which I have seen that the financially important parts are related not to minor items of administration but to the great substantive parts of public activity. Therefore, an economy drive of this type may lead to a reduction in expenditure in hundreds of items by about 20 per cent but in the whole of the budget by only 1/20 per cent. And they may be very popular in that respect, but actually reduce rather than increase efficiency in actual financial administration. It is from this point of view, I think, that it is particularly important, as a basis for checks on economy, to maintain even at the accounting and auditing stages a very clear idea of the productivity and efficiency of various items of expenditure, so that one may not fall into the usual mistake of over-emphasising small economies and forget how little they mean for reduction of public spending as a whole, by comparison to points which are politically important and sensitive.

### Questions and Answers

*Q. No. 1:* Sir, I have two questions to ask. The first relates to the broader aspects. What would be the governing principles when budgets are made in countries like China and the Soviet Union? Are they very different from the points you have underlined?

Secondly, in your country in particular, and Scandinavia in general, the way the cooperative movement has developed, do you think it has something to do with the manner in which budgets have been allocated? And how do these movements affect budgeting in these countries?

*Answer:* The second question is one I am glad to answer. The first one I am totally incompetent to answer.

I do not know, unfortunately, and I think very few people know, how the set-up of the budget is in the countries which have the type of Government as China has, or indeed in any country where socialism is practised, not in the sense in which the word is used in India but in a much more far-going sense. There, the public sector comprises the whole of the economy, and it should be true—whether it actually is true I do not know—that the practices of budgeting for private enterprise will have to be introduced into the public sector to a much greater extent than is the case in countries which still have a mixed economy of the type we have in Sweden and which I think you have in India.

But even in countries which have a mixed economy, it is necessary to draw a distinction, let us say, between the railways on one hand and the law courts on the other. The system will be different. Budgeting for the railways will be much more influenced by the practices of private enterprise. That is as far as I can get with your question of principle.

With regard to the second question, the answer is simple. The cooperatives in countries like Sweden or Denmark or Norway or Finland or the U.K. do not affect the public budget at all, because the cooperative movements there are not, as I know is the case in India, an arm of the State. They are totally independent of the State. They make their own budgets just like any private enterprise. They normally receive no grants from the public. There are exceptions to this. But in the case where a cooperative receives grants from the public, as has been true for instance in some cases like producers' cooperatives in agriculture in Sweden, the grants are made up in exactly the same way as if grants were given to a private enterprise to do something for the Government. There is an arrangement between them just as there may be an arrangement between the private enterprise and the Government for a given service. But the cooperatives in our system do not at all form part of the Government budget.

Now, I can give you an instance to illustrate this, and that is the case of the housing cooperatives. They build the houses, and the housing cooperatives are an important element in the housing policy of the Government; but they receive no grants. The only thing they do is that they are allowed to



collect rents, and they may be given particular loans for their investments. These loans will appear in the budget as loans granted to the housing cooperatives. Only to that extent would they appear as part of the public budget. Normally, where grants of this type are made to a cooperative organisation, similar grants would be available to other organisations as well. Thus, the loans granted to housing cooperatives are not limited to those. They are available to private individuals building their own houses and appear under the same heading in the budget.

*Q. No. 2 :* Does the frequency of supplementary budgeting not promote laxity? You present three times a year your supplementary budgets. Therefore, departments may feel confident that they will get their money in the next one, or the next one and so on.

*Answer :* That was true sometime ago. But normally it is much more difficult to get an appropriation in a supplementary budget than to get it the first time. Therefore, departments will know that they cannot come back with supplementary budgets for grants which they fail to present the first time. They will have to give a particularly careful justification for the supplementary budget. However, I do not see how it can be avoided. All countries must have some reasons for supplementing their budgets!

*Dr. Khosla :* One or two, but not three.

*Prof. Heckscher :* Well, it is normally two, but it was three during the war.

*Q. No. 3 :* What is the percentage of tolerance? How does this affect when the department is asking for budget provision? For example, in some cases it does happen that a department has a supplementary demand and yet has surrendered amounts more than supplementary demand asked for.

The second question is: what is the device for providing for funds for advance sanction, particularly in case of public undertakings where they have to place orders years in advance for machinery which has to come from abroad?

*Answer :* With your permission I would like to save the first question till my next talk which will cover that ground.

As to the second question, this problem arises not only in the case of public enterprises. It will also appear in the case of the armed forces, for instance, and procedures differ. In my country which is the only one where I have practical experience of this problem, we have something which is called authorisation. This will be approved by Parliament and not only mentioned in the budget, but go through the usual mill of budgeting. But of course, it will not appear in the figures of the budget. This, however, has something to do also with the problem of long-term expenditure which I have mentioned before. Normally the need for advances of this type is related to expenditure which covers a long period of time. A credit may be opened. I think in some countries the system is that the credit is opened for a given authority or agency to pay as they go. The procedure to be used may also be to appropriate the total of the money for the opening of that credit.

The other system may be to try and calculate how much is needed and provide the money for reservable items for that purpose, whether it is a question of a public enterprise or only an agency.

*Q. No. 4 :* You said earlier in your lecture that in some countries, especially in the USA, there is a device provided to the legislature, whereby scrutiny is done on its behalf after the Government has approved the budget. I would like to have more detail on the subject because as far as my limited knowledge goes, a few States, hardly two or three, have adopted that system, which is not reported to be very effective, because in the case of a small State like Oregon the budget was about 400 pages. And about two or three budget analyses on behalf of their legislature ran into 1,000 pages and it was a subject of great criticism.

So that is just an example of how that very system can be self-defeating. I do not know about the Federal Government. Could you give me a little more idea how it is exercised, how the budget is analysed on behalf of the legislature?



*Answer :* First of all, I agree completely with you that this is a most obnoxious system with most unsatisfactory results. What happens is this: in the Federal Government and in several State governments—not all of them—the budget is brought in, and various committees, let us say, of the Senate and the House of Representatives start scrutinising it. They call for evidence of all sorts and as a result they find that much more money should be given, let us say for a dam for Tennessee, and all the members from Tennessee will agree that this requires a much larger appropriation. At the same time, somebody wants more money, for let us say, schools in Massachusetts, and all the people from Massachusetts will agree on that. Then the Massachusetts members will vote for the dam for Tennessee and the Tennessee members will vote for the schools in Massachusetts. The result is that the budget is increased at both points, and the Federal executive sometimes will have to take very strong measures indeed to prevent the budget from being changed out of all recognition by methods such as these.

Admittedly, the tendency even in the Federal Government has been to reduce this practice in later years. As late as the 1930's, it was very usual, but it is still employed quite frequently and especially where the majority of the House, or even of both the House and the Senate are not in political harmony with the executive. Quite often, the party commanding the legislature will use the power precisely to change the policy presented by the executive of the Bureau of the Budget and present them with a budget which is something different from what they originally proposed.

*Q. No. 5 :* Reference was made to the practice prevalent in the U.K. and France whereby special attention is devoted on new items of expenditure as compared to the recurring items of expenditure. As you know parliament has hardly time or the will to control expenditure. Is n't it better that this system is adopted so that at least that particular project, or the new item of expenditure relating to that project, is fully scrutinised before that project is launched?

*Answer :* I will agree that it is necessary that there

should be a careful scrutiny with regard to new items, but I would not agree that it would do for either Parliament or other financial authorities to leave the recurring items without careful scrutiny. I sat for a number of years on the Budget Committee of our Parliament, and the practice we employed was this. Members were given an opportunity at a certain time of the budget to present amendments. Two weeks after the presentation of the budget, amendments could be proposed. Amendments could be for reduction or increase.

If it was for an increase, there was one chance in a thousand of getting it adopted, whereas if you proposed a reduction, there was a chance, even as an opposition member, to get Parliament's support. Then the matter came to the Budget Committee. We went very quickly over all recurring items on which no amendments were proposed. They were adopted practically without discussion. But both the new items and those recurring items where there were amendments were made the object of the same scrutiny and hearing of evidence and whatever procedures we could use, and we found that this had a very good effect on the Government, because they never knew whether or not they would have to present justification even for old items. If some member took it into his head to propose an amendment to that item, then justification was asked for. I think on the whole that was a fairly useful practice.

*Q. No. 6 :* You were mentioning about efficiency and productivity audit and that wherever possible we should apply this criterion in terms of costs and returns, but don't you think there should be some criterion or standard to go by, if you were to evaluate a particular organisation whether it is productive or not. What kind of criteria are there in Sweden or any other country with which you are familiar?

*Answer :* It is a question which is practically impossible to answer. Of course you can to some extent have a criterion but it may be rather dangerous. Let us take the example of the police. If you measure the efficiency of the police by the number of people arrested, then obviously the implications are

rather far-going and not very satisfactory. What other quantitative measure could there be? You should, of course, follow the practice of the Greeks where you paid the doctors as long as you were well and measure the efficiency of the police by the reverse number of arrests: the less of arrests, the less the crime and the more efficient were the police ! Even that would be rather difficult and I think it is practically impossible to measure in quantity. Actually, of course, you can get an impression. In the case of general administration, you cannot possibly find a measure. You can say it is obvious that this administration is efficient and you give examples showing it, or you can say this administration has obviously not been efficient and give examples showing that. But you cannot find figures in the way which you can in a physically producing production agency where the input-output relation can be put down on paper. You cannot do input-output relations either in the armed forces or in the central services or in education or in the administration of law and order. In the case of the railways you cannot apply a profit criterion for the simple reason that the question is not only one of profits of the railways, but of profits to the economy as a whole. In many cases you may see that a given part of the railways runs at a loss but the economy of the region which the railways serve is prosperous, and in that case it may be perfectly reasonable to allow the railways for a time to be run at a loss, and they may be extremely efficient and productive in spite of that fact. The same thing may happen in other services. But I think the railways are a particularly good example.

## II

*Prof. Gunnar Heckscher :* My remarks at the previous lecture were of a descriptive nature. I might try now to dwell on some of the most crucial problems.

Of the things which I am going to talk about today, the first is the one which I referred to yesterday in passing, namely, the question of subjective and objective budgeting. I had tried to explain my terminology as being slightly distinct from that used by Dr. Thavaraj. By subjective budgeting I mean the type of budgeting where the emphasis is on the functions, *i.e.*, on the subject. You budget for certain services, for certain number of employees, assigning certain sums for different kinds of expenses. You budget certain sums for equipment even if the services, the expenses and the equipment are being provided by the Ministry or agency in question for very diverse purposes. You will then be able to see how much the agency is allowed to spend on various types of expenditure. But you will not see how much of costs go to achieve a given objective. Objective budgeting, on the other hand, is when you make up the budget more or less regardless of the function but in relation to the objectives to be achieved, services to be rendered and so forth. Now obviously, it is practically never possible to have a budget which is wholly subjective or wholly objective. There will always be an element of each in any budget. There will obviously be different types of expenditure, not only in the case of, let us say, things like social services, or investments, where you cannot budget except for a given objective. You budget,

for instance, for old-age pensions. You cannot possibly find any system whereby you do not have to see at least how much is going to be spent on these pensions. On the other hand, there are a number of services which are used, and must be used for very different purposes. Now you cannot possibly budget for each particular objective separately because the service in question will deal with all of them.

I will give you an instance which is very relevant to my present occupation—the cost of an Embassy. You cannot possibly split up the cost of an Embassy ascertaining that so much is spent for providing passports and so much on public relations, so much is to be spent on reporting and so on and so forth. It is necessary in that case to have what I am calling subjective budgeting. But even so, the emphasis may be more on one or more on the other.

The term 'performance budgeting' in this terminology is used for something which goes even further than what I here call objective budgeting. That is the type of budgeting where the appropriations, or rather the sums available to the Ministry or agency are more or less directly related to the services rendered, so that with an increase in services, there will be a more or less automatic increase in the money provided for those services. Performance budgeting is usually used in the case of public enterprises, because there, quite obviously there is an input-output relation, and at least to some extent the amount of funds available to the agency, or to the enterprise, is related to the business activities of that enterprise. In some cases, the public enterprise is run almost on a commercial basis: the public enterprise pays its way and a little more. There will be very few limitations actually on its expenditure as long as it is run at a profit. The limitations there will be chiefly related to major investments for the future which have to be financed out of borrowing, or which for other reasons, for instance of cyclical policy, have to be limited at a given time and increased on other occasions. But on the whole, the tendency in all the countries which I have studied is for public enterprises to work on what I would call the basis of performance budgeting.

Apart from that, in most countries, subjective budgeting is the normal procedure. They budget for the services, for the

types of expenditure without much relation to the particular objectives. This is so on the whole in the U.K. It is very definitely so in France. I should say France has subjective budgeting with a vengeance, even more than any other country I know of. I should say that probably my own country, Sweden, comes second. There also, subjective budgeting dominates to a very considerable extent and it is actually, in most cases, very difficult to see from the budget what is spent on a given type of expenditure. This has caused considerable concern, and experiments are now taking place with objective or even performance budgeting, in selected parts of the administration.

Now, if you are to move from subjective budgeting into objective budgeting, it means that you would leave the spending agency, whether it be a Ministry or an agency, freedom of choice between different means to be employed to gain a given objective. You may say, for instance, that such an amount is set aside for a certain objective. Whether they spend it all on personnel, all on equipment, or part on personnel and part on equipment, is their choice and will depend on the circumstances. In a country such as my own, where there is shortage of manpower, shortage of personnel, with a comparatively good supply of foreign exchange, it would probably in many cases be economical to reduce personnel by introducing labour-saving equipment, even if that equipment is to be imported. On the other hand, in a country where there is a shortage of foreign exchange and a good supply of personnel and manpower, you would go the other way. You would refrain from using labour-saving equipment, you would still employ procedures which require a considerable amount of manpower and a considerable amount of personnel, so as to avoid the difficulty of importing labour-saving equipment.

But there is not only a permanent difference between different types of environment, in which case our problems would be fairly easy to solve. There may in many cases be a choice to be taken at a given moment. For instance, in a certain office you may have the possibility of having two more stenographers or a dictaphone. If you have a dictaphone, you can use typists with far less training and the initial investment and the comparatively small current expense for that purpose would, therefore, simplify matters. You may be able to decide

on this at the moment when you find that the skilled stenographers are not available: that is to say you do not have to decide it in advance when the budget is established. You decide it at the point where the need arises and you find that the means you previously employed are not sufficient to gain your purpose. Objective budgeting leaves the spending agencies this freedom of choice. Therefore it makes their work more flexible and in many cases I would say, also more efficient.

Now there are countries which to some extent—I do not think completely, because it cannot be done completely—have introduced this system. The United States, and in particular I would say the States rather than the Federal Government, and even more the cities, which have often a different type of administration, have gone a long way towards introducing objective budgeting. In the Federal Government it is more difficult, partly because the Federal Government deals with things where objective budgeting is often much more difficult, e.g., the foreign service and defence. I think it is true to say that in the United States there is a very strong general trend towards objective budgeting, and this is to some extent influenced by the fact that in the United States private enterprise is almost invariably held up as a model to the public services, and in private enterprise objective budgeting is the rule. Of course, they are not bound by the need to have a budget to be approved by Parliament or Government authorities. They can make whatever changes they like in the current year. The shareholders' meeting does not decide on the budget for a private enterprise. And because this is so, and because the traditions of private enterprises are so strong in the United States, they have at this point been able to influence, first municipal government, then State Government and to some extent even Federal Government.

But there is a European country which has also gone a long way towards objective budgeting, and which, in fact, has introduced something which involves even performance budgeting, and that is the Netherlands. In the Netherlands, budget reform has been going on for a long time after the war. The traditions of objective budgeting and performance budgeting were established chiefly during the seven year period of Prof. Pieter Liefstinck as Finance Minister of Holland. He

eventually moved to the World Bank and then to the International Monetary Fund. But when the Dutch were setting up their administration after the war, they could begin more or less with a clean slate and Prof. Liefstinck, who did not come from the public services but from academic life, with some experience of business, consciously introduced a system of this type. Of course, even there elements of subjective budgeting remain to some extent.

But when I say that they even have a system of performance budgeting in some cases, I am thinking of the control exercised by the Finance Ministry. In fact, in Holland when an appropriation has been passed by Parliament, that does not mean that it is necessarily available to the services in question. It still requires specific permission from the Finance Ministry to release the credit in question, and the Finance Ministry is free to refuse it on different grounds. It even happens, and this I think is a characteristic which exists nowhere else, that the Finance Ministry will refuse to release funds for a given purpose because the appropriation is too small. They will say that the appropriation is insufficient to achieve the objective and therefore rather than use some money without achieving the purpose they will release no money at all. This means, in actual fact, of course, that they put themselves up as judges even above Parliament and say that Parliament has made a mistake in granting too small an appropriation for the objective in question.

I do not say that this happens very often, because obviously the knowledge that the Finance Ministry has this power and may use it in certain circumstances would influence the same Finance Ministry when it is making up the budget. So when they plan the budget and when they approve the appropriations at the initial stage, at the stage of establishing the budget, they will take specific care not to put themselves in the position where, later on, they may have to refuse to release the appropriation which they approved originally. But it means of course, also, that Parliament has to be very careful in reducing appropriations, and, in fact, I think the main outcome of this—I rather believe that this was to some extent Pieter Liefstinck's idea—has been to increase enormously the power of the Finance Ministry. The Finance



Ministry comes in at both ends; both in the establishment of the budget and in the substantive control over execution, and this means that they exercise even more power than Finance Ministries in other countries; and this is saying quite a lot because Finance Ministries are, of course, very powerful all over the world.

Now, I have gone into this at some length, because I feel that this tendency which we find in the United States on the basis of the idea of private enterprise, but which we also find in a country like Holland on quite different grounds, is probably something which will be under discussion for a long time, and which is likely to influence budgeting all over the world, in particular when the scale of activities of the State is growing and those parts of public activities which are of a more or less economic character take on larger importance; because then the result will be that the model of private enterprise will have to be used to an increasing extent even by public agencies.

Now you may understand from what I have been saying that I regard this development on the whole as very beneficial. I think that in the circumstances of the modern State, it is quite definitely an improvement that we get more of objective budgeting and even an element of performance budgeting to a greater extent than before.

But I would not be quite honest if I were not also to point out that there are rather serious difficulties inherent in this system, and these difficulties are to some extent, at least I think to a major extent, related to the questions of accounting, audit and all sorts of controls. Objective budgeting is possible, and even natural in a comparatively small organisation where the leadership can exercise far-going control over the whole of its own administration. It is also something which would be ideal provided human nature were such as to make no controls necessary, provided you could assume that administrators are all-wise and always completely selfless. In these circumstances objective budgeting would be the ideal. On the other hand, it is quite clear that in the real circumstances of the world, and human nature being what it is, we must look at the other side. Objective budgeting, of course, is in some respects advantageous even from the point of view

of post-audit or current control through accounting and current audit. To the extent that control is related to efficiency, this type of budgeting facilitates it. I would even say that as long as it is related to real economy in administration, the input-output relations, the relationship between the funds made available and the extent to which objectives are gained, that relation is more obvious, and therefore also it is easier afterwards to check whether this has been achieved. But you will remember that we talked about other aspects also of auditing, such as checking of the honesty and the reliability of the administration and the legality of expenditures; and that obviously becomes more difficult in a system of objective budgeting. If the administrator wants to cheat, wants to be dishonest, it is much easier if his budget is based on the achievement of a given objective without specification of the means which he has to employ. It would then be rather difficult to find out if the means he has been employing are dishonest, as long as he has achieved the object reasonably well. And that is all that would appear from a study of the input-output relations, and if he wants to employ means or practices which are not acceptable, then even a rather careful audit might not find him out.

I shall stop here for a moment and go over to the second problem which is related to that of objective and subjective budgeting and where the character of the problem is much the same. And that is the question of details in budgeting. To what extent does the budget go into the details, small figures even, in regard to appropriations and allocations for given purposes? Now in many countries, and again both France and Sweden are typical, the budget is split up into a great number of items, some of which are comparatively very small. I once made a study of the Swedish budget in that respect, and I came to a total figure of about 1,500 items in the budget of the Swedish Government, and going further I found that nine out of these 1,500 items were responsible for two-thirds of the expenditure; the remaining 1,491 items were responsible for only one-third. This detailed budgeting is something which you find in countries like France and Sweden and in a great number of other countries as well—I do not know what the situation is in India, but I know that in another developing



country, which I once studied, *viz.*, Turkey, budgeting was more or less on the same lines as in France in this respect. This system has historical explanations. It also has political explanations, because it means that the budgeting authority, and traditionally this used to be Parliament, can exercise much political influence over the administration by deciding that so much money is to be used for this little item and so much money for the other, thereby binding the administration in its activities to follow along the lines where Parliament wants it to go.

On the other hand, of course, the system has very great disadvantages. The budget is normally made up, or at least begins to be made up, anything from half a year to one year before execution even commences, which means that it will be approximately one year behind your forecasts. Many things happen during one year of administration, and quite frequently you will find that these small items are unrealistic. You may find that due to unforeseen circumstances you provided too much money for one purpose, too little money for another purpose, and the administration will find itself bound by these appropriations and allocations, and its activities will be correspondingly hampered. It also sometimes leads to rather undesirable practices, for instance, the practice of spending whatever is left over in a given item just before the end of the budget year. It is a practice which I think we all know because it happens in all administrations where subjective budgeting is employed, and the cause of it is that if, when the budget is established next time (or rather the time after next because there is a time-lag in between), the Ministry or agency in question has not spent its appropriations, the Ministry of Finance will be inclined to reduce them, whereas, perhaps, the situation was that they had too little need of one detail that year, while in the subsequent year there may be more of it. This does not appear because in any case they were not allowed to spend more than was provided for, and in order to avoid difficulties of this type, they will spend, not according to their needs, but according to their forecast of the effect of spending on future budgeting. This, obviously, is far from satisfactory. You will also find that sometimes, because of this detailed budgeting, an agency, even a rather small agency,

will be rather haphazard in its spending. They will spend money simply where it so happens that they have been provided with reasonably good funds.

I was once Chairman of the board of an approved school, where certain sums were needed for food, certain sums for clothing and so forth. The sums for clothing were insufficient and the sums for food were too high. So the children in the approved school at the end of the budget year got sumptuous meals, but it was very difficult to provide them with decent clothes when they were discharged. Now, the answer to this obviously is either to do away with detailed budgeting and provide a lump sum, or else to find some means whereby transfers can take place. In the French system and also in many other systems, in fact, there is provision for something which is called 'virement', that is transfer of sums from one item to another. Normally the spending agency is not permitted to do this entirely on its own. They will require permission from some superior agency, sometimes even from the Finance Ministry. But they will not normally require parliamentary approval: which means that in the course of executing the budget, if you find you have provided too much at one point and too little at another point for the same general purpose, you will be permitted to transfer money from the item which is too high to the item which is too low. Actually this means introducing by the back door something which is rather like objective budgeting. You still split up your items according to the subjective system, but you provide the means whereby a certain amount of objectivity can be introduced in the execution.

There is another device which comes at an earlier stage, and which I think can be combined with performance budgeting. That is what we have been calling in our political discussions in Sweden—it has not been employed to any major extent but it has in some cases—framework budgeting. It means that Parliament and the Finance Ministry after hearing the demands of the spending ministries will allocate to each of them, a lump sum and so you make up your budget on the assumption that the total of your budget is such an amount. The spending ministry will then do the same thing to its subordinate agencies. They will say, "Well, this is what we have

got from the Finance Ministry. We have to divide it up. Now we feel that for this particular section of our work we cannot provide any more than that. But we leave it to you. You have more experience than the central officials of the Ministry to say how you are going to divide this up between the different items in your budget." Admittedly, this does not permit changes of scale during the period of execution of the budget. But on the other hand, it does at least give the substantive authorities more influence over the actual spending than they have under the old system.

We have employed this in some cases, for instance, in the case of some semi-public institutions which draw most of their funds from the Government, but technically and constitutionally are not part of the administration. They will be given a lump sum and freedom to use it according to the budget they have established for themselves.

We have been also using it to a considerable extent in defence, and here I think I should like to make a brief excursion and tell you how our system has been working in this field. Of course, the defence budget today of any country is a very considerable part of the whole. The problem confronting it originally was a political problem, to prevent questions on military expenditure and defence from becoming too important in party conflicts. In order to avoid that, one Royal Commission after another was set up to study defence. These Royal Commissions included parliamentarians from all political parties and worked on the basis of proposing a framework for the total cost of defence per year. Normally, these reports and the decisions subsequently taken unanimously, or more or less unanimously by Parliament, covered more than one year. Agreement was made on defence expenditure for two, three or even four years, and the decisions were for a lump sum for defence as a whole. It was then left to the military authorities between them to split this up, or rather it is for the Ministry of Defence to divide up the lump sum among different forces, and then the Chief of the Army and the Chief of the Navy and the Chief of the Air Force themselves will bring forward proposals to the Defence Ministry for spending within this sum. Actually we found that this system worked very well. Parliamentarians are not military experts. It is,

therefore, not very easy for them to take the detailed substantive decisions necessary in the highly technical field of modern defence. On the other hand, I think it was Lloyd George who once said that defence is far too important to be left to Generals. And for this reason you cannot possibly let the military decide how much money they are going to spend on defence. We found that framework budgeting made it possible to combine in a rather satisfactory way the technical knowledge of the military personnel and the political sagacity of parliamentarians from different parties. We were on the whole rather happy with this system.

To sum up: in using the word "efficiency" it is necessary always to remember that the word is closely related to the word "effect". Efficiency means finding the best means to achieve a given objective, a given effect. It means that in administration emphasis has to be put on the objectives of administrative functions rather than on the niceties of procedure. It has to be brought in from the pure economic field into the field of administration. Even when productivity cannot be measured in figures, and this is very often the case in public administration, the very idea that administration should be productive of a given effect has considerable influence on the working of modern public administration, and it has to be brought in at least to the same extent in budgetary structures and procedures.

Related to this is the problem of decentralisation. The growing administrative structure—and all modern countries have an administrative structure which is growing—will be increasingly dependent on decentralisation and delegation, otherwise it will become unbearably slow and cumbersome to the public. Decentralisation cannot stop short of budgeting. Decentralisation must also mean that you decentralise financial decisions to a considerable extent. Moreover it is necessary to get rid of some of the fictions connected with budgeting. I referred in my earlier lecture to one of these, namely, the question of the financial year or the budget year, which is quite obviously nothing more than an auxiliary device—just as a five year plan is, of course, an auxiliary device; it does not mean that you will achieve miracles exactly in five years, nor will you achieve miracles exactly in one year. Your miracles, if you

achieve them, may take three years four months and twenty-five days just as often as any other fixed period of time. On the other hand, budgeting will, of course, have to be based on some time schedule. What is necessary is to see that these auxiliary devices, such as financial years and five year plans, do not achieve a life of their own. We have in some cases a device—I think it is used in many countries, although I have chiefly seen it in my own, and there again I would refer to the experiences of our defence budget—what is called “a rolling budget”. You make up your planned expenditure, let us say, for 4 to 7 years, or whatever it is, but you change it every year. That is, every year you make up a new plan. If I were to transfer this to the idea of your five year plans, it would mean that you introduce in 1966 the five year plan for the period 1966-71. You then introduce in 1967 another five year plan for the period 1967-72, taking into account the experience you gained in the first year. Then in 1968, you get a plan for 1968-73 and so on and so forth. You will not be bound by the period of five years. You will be able to make the necessary changes as you go. But at the same time, you will be able to plan fairly long in advance. To some extent, I should say this procedure can be used also with regard to the normal budget and annual budgeting. You can make up a budget which in form is for one year, but which actually is a rolling plan for, let us say, three years or four or five, taking into account the possible forecasts for the period after the budget year. And, of course, if you have to use the devices which we have been talking about before, you may also be able to make changes in the course of the budget year.

This means of course that in the whole field you have to introduce procedures which are more flexible than the traditional ones. It must then be remembered that these less rigid procedures demand a high degree of honesty and devotion to duty on the part of the administrative personnel. But they require even more. They require not only that honesty and devotion are actually present, but also that the public is confident of their existence. As long as the public, rightly or wrongly, is suspicious of administrative agencies and their personnel, they will not be prepared to accept these more flexible procedures. That is, I think one of the crucial

problems. Because as long as procedures are inflexible it is unlikely that confidence will be forthcoming. On the other hand, if confidence is not forthcoming, it is difficult to get rid of these inflexible procedures. This is the type of difficulty with which we are always confronted in public administration. The fact that our administration has been going on for such a long time with a modicum of success seems to indicate that this type of problem can somehow be solved, and I think it can be solved in budgeting as well as in other fields.

### Questions and Answers

*Q. No. 1 :* You were talking of police and the armed services. What is the test? More arrests made or less arrests made? The answer I think lies not in the arrests made or arrests not made. It is the social order which is wanting to be on-going. The test would be: does it promote an on-going social order? Does it promote harmony? Investment on police will not be on what the police has done by their own function but something outside, in the social function which they promote.

There is something like deceptive budgets like the type of budgets which Hitler made in which heavy expenditures could be hidden. My question is this: How on earth do the other related facts get hidden?

How could a small country like Poland manage to have 500 aircraft? Secondly, how could this country afford to spend so much on defence without the risk of breakdown in social order?

*Answer :* The harmony of the social order can usually not be measured in figures, and budgeting is concerned with figures and that is the reason why it is so difficult to find a measure. You will remember that yesterday Dr. Thavaraj used the words ‘measure for the productivity’. You may say that a given system of policing is on the whole efficient or inefficient. But to measure in figures let us say, the increase of efficiency which you may gain by certain additional appropriations for a certain purpose is practically impossible. You will have to rely more or less on arbitrary judgment in order to assess the

relations between input and output in an administrative situation like that.

With regard to your other question, that is on deceptive budgets, Hitler could present deceptive budgets because he was safe from opposition. In a democratic system, particularly in a system of parliamentary government it is the business of the opposition to investigate carefully and put its finger on anything which is deceptive. If the opposition fulfils that function, which I should say it does normally in countries like U.K., Sweden and France, the Government will not even attempt to present a deceptive budget because if they do they run the very serious danger of being kicked out. Therefore, the very existence of a watchful opposition has considerable effect on the working of the Government. It is necessary, of course, for this purpose that the opposition should do a lot of thankless spade work. And actually you will find that sometimes the work of the opposition in this respect is more helpful to the Government than to the opposition parties themselves because they will not gain very much from it in elections. But they will, on the other hand, perform a useful function for Government.

You asked how the Poles could provide for 500 aircraft secretly. That is related to your third question: How are we to build up a defence system in any country, India or any other, when the expenses run so high that they may upset the whole of the social order? Again that is a question where you may say that you will have to run risks on both counts. You will have to provide a defence system which is perhaps not enough to get you full security. But, on the other hand, you will also have to build up a defence system which costs so much that it precludes you from doing what you would like to do in other fields, such as education, social security, etc. It is a question of rather hard-headed decisions; and not merely that, but also courageous decisions about priorities, rather than falling back on wishful thinking, either of the type that you think you can achieve complete military security or that you can feel so secure that you do not have to spend anything at all on defence.

We have had this problem for a long time in Sweden. I think the question of our defence expenditure in fact was our major political question from about 1910 until about 1940,

that is until the beginning of the second world war. We thrashed it out over and over again. We quite often found the results very unsatisfactory on both scores. But in the end, by trial and error, and because we were lucky and avoided having to put our defences to actual use, we have now achieved what we think is a reasonable balance. The balance, of course, will be different from country to country. It depends on the political and strategic situation. It depends also on its economic potentials. There is a mean which can be struck, but of course it is not always a popular decision to take either way.

*Q. No. 2 :* Many years ago Mr. Bevan suggested that a normal budget should be prepared for two years instead of one year to make proper utilization of the funds.

You have also mentioned about honesty and devotion. I have seen that in spite of the huge volume of rules and regulations to check dishonesty in spending of funds, we have not succeeded altogether.

One main drawback is this, that we attach too much importance for minor things. We think Rs. 2 is the same as Rs. 20 lakhs, Rs. 50 lakhs or Rs. 2 crore.

*Answer :* With regard to the annual budgets, I mentioned in my earlier talk that in the Netherlands there is a constitutional provision which makes it possible to have biennial budgets. It is the only country I know which has such a provision. The point is that it has never been applied. I think the reasons for this are political rather than economic. It is simply that parliament will not be satisfied if such a long period has to lapse between the decision taken and the actual execution, but it can be done in many ways. I think in many countries, there is a tendency today to emphasise, not financially, but in the discussion, certain parts of the budget in one year and others in the next year. The whole thing will work much like what I have been calling a rolling biennial budget: that is the decisions will be taken I think for two, three or four years rather than one but it will not be taken for the whole budget at once. You will go into different parts at different times.



Your second question about regulation and dishonesty is perfectly valid. A great number of regulations do not provide for more honesty and quite often the effect is to the contrary. If you regulate too much you open avenues of dishonesty which should not exist otherwise. But I was discussing this from a very specific point of view, that is of objective or subjective budgeting. And there I would still say that objective budgeting does provide more opportunities for dishonesty than subjective budgeting, whereas on the other hand a great number of details introduced into the budget do not necessarily provide for greater honesty.

Finally, you said that, related to this problem also, there was a tendency to put too much importance on minor things. Yes. This is a very curious thing. I noticed it in a fairly long political life both on a municipal body where I once sat and also in Parliament. Members are much more interested in discussing the small sums than in the large ones, and I have been asking myself: why is that so? I think the psychological explanation is really rather easy. A sum of Rs. 10,000 is intelligible to every one. We all have some experience of what it means. A sum of Rs. 10 crores is completely unintelligible to most people. They just do not know what it is. They have never seen it and they have never dealt with it in their private affairs and therefore they actually fight shy of discussing problems of this type which lie entirely outside their personal experience. It is, if you like, one of the shortcomings of democracy, except that you will remember that in a dictatorship probably the same thing would apply to the people actually in power. You do not have a philosopher king governing in a dictatorship today, and even if you had a philosopher king, he would be unlikely to be a budget philosopher. So normally you will find that this is a difficulty which arises in all systems of modern government. We are dealing in Government, and budgeting in particular, with figures which are to use a hackneyed term astronomical, even to the extent that to most of us they seem to be in the stars rather than on this earth and therefore we are unable to understand what they actually mean.

*Q. No. 3:* In India planning is centralised, plan

exercises are spread over a number of years. In the case of the rolling plans much attention would be diverted from execution to plan formulation and there will be paid more attention in plan formulation rather than in plan implementation.

Secondly, you have been pointing out the desirability of decentralisation and delegation. Every one shares the desire; but centralisation asserts itself, because in the complexities of modern management of large-scale enterprises, or activities on a large scale, there is not the same flow of competence to the lower levels as there are at the higher levels. Therefore even though you decentralise on paper, there is a tendency for re-centralisation in practice. So, is there any system by which we could decentralise competence along with our plans for decentralisation of functions?

*Answer:* I think both of your questions are very relevant. But on the first one, I am afraid, I do not agree with you. The situation is, I believe, quite the contrary. I would say that a rolling plan would have to take much more account of implementation than a plan which is for a fixed period of time. If you make up a fixed five year plan, then after the plan is made up, there is no current checking on implementation or at least there does not have to be. When you then come to the end of the five year period, you may be able to say—"Well, we fell short on so and so much on this point and so and so much at that point. We are very sorry. But now we are making a new plan for another five years and we are going to make good all that we fell short of last time and do a lot besides." And you present that with great hopes and then you leave it for another five years and at the end of those five years, you may have to say more or less the same thing—"We failed at certain points but we are not going to fail the next time", which may or may not be true. Whereas, if you have a rolling plan, the idea is that you will always have to present the extent of implementation which has taken place, and therefore you will keep tabs on implementation the whole time.

Let us say that you are including in the plan two steel

plants, and you are expecting to add two more steel plants later on. This means you begin with the first two steel plants in 1966 and you expect to begin with the next two in 1970. By 1967 you can probably not say very much about the first two. By 1968 they should be well under way, and in making up the five year plan from 1968-73, you will already have to say quite a lot about the two new steel plants, and in drawing up your plans there you will have to refer to the experiences you actually gained in planning the two first. Thus, in a rolling plan, I would say, the relationship between planning and implementation is clearer than it is if you make up fixed long-term plans.

The second question is of course a very serious one. It is quite obvious that decentralisation becomes a mere sham unless people at the lower levels are able to accept responsibility. I realise that this is a very serious problem in many countries and probably not least in India. It is quite clearly a difficulty. On the other hand, I would say also that as long as you do not decentralise and delegate authority, you will never have good people at lower levels. The effect of decentralisation on personnel policies will show up : you will have fewer attractive posts at the top, at the centres, and more attractive posts at the lower levels. You will decentralise authority. But authority always attracts competent people. You can not make competent people accept a post which does not carry authority. Therefore, as long as your administrative system is centralised, you will risk finding indifferent people at the lower levels. Decentralisation has a different effect. I think we have seen this in Western Europe and also in the United States, perhaps particularly in the United States, where the more modern systems of City Government and State Government have attracted administrators who are at least quite as competent as those who are available to the Federal Government, because they carry authority. A person who can be a State Governor may even prefer that to being Attorney-General of the United States. He may feel that the post of the State Governor is more important, gives him more authority than that of Attorney-General at the Centre; and he will find that the post of Attorney-General in a state is more attractive than the post of Assistant Attorney-General to the Federal Government and so forth. Even when you

have a Federal system, which incidentally of course you have here, the same thing would apply. We have in my country a system of administration which is rather similar to what you find on the European continent in general. Provincial governors are appointed by the Central Government. The recruitment to these posts, which are purely administrative, is extremely satisfactory. Former Cabinet Ministers, former Secretaries, leading politicians, even from private enterprises, will very gladly accept appointment as provincial governors because they know these posts carry a considerable amount of authority—territorially limited to a province, but within that province wide and important. I would say therefore that to some extent at least decentralisation attracts competent personnel to the lower levels.

*Q. No. 4 :* To what extent would you advocate a fully divided budget only in the non-investment sector of the Government ?

*Answer :* As a matter of fact I am not altogether happy about a divided budget at all, because I think the distinction between capital budget and current budget, or investment budget and current budget, is one of the artificialities of our budget system, and for two reasons. In the first place, very often it is difficult to say whether a given expenditure is for investment or for current expenses. Small investments, such as buying typewriters, will always come on to the current budget but are nonetheless in actual fact investments. The typewriter is not worn out in one year, at least not if the typist is reasonably competent. Therefore, it is actually an investment which should carry over a number of years. Still, it can never appear in the investment or the capital budget. Moreover, there may be a choice (as I tried to point out before) between investment and current expenses. You may sometimes try to achieve a given objective by deciding either on investing this year, let us say, Rs. 10 lakhs, or spending, let us say, Rs. 2 lakhs for each of the next five years. And one comes on the capital budget and the other comes on the current budget—but actually the choice is an administrative and not really a financial choice. So I should say that a totally divided budget will always be something of a fiction. What you need is to decide to what extent you are going

to finance your budget by borrowing. And then you come out of the realm of administration into the realm of economics. Because there is not only a question of financing certain types of expenditure by borrowing and other types of expenditure by tax revenue, it is also a question of the cyclical situation or cyclical policy. You may say at a given time it may be necessary to finance even long-term investments out of tax revenue because it is necessary to prevent overheating in economic life. At other times it is necessary to stimulate economic life and then you have to borrow more. Thus you have the old Keynesian theory, to the extent it is applicable, coming in at this point. And if you have a completely divided budget, you will still have to finance some of your investments out of revenues in certain years. In other years you will perhaps finance some of your current expenditure out of loans, and the whole distinction becomes, as I said before, more a fiction than a reality.

*Chairman:* Well, friends, we have heard two very interesting lectures from Prof. Heckscher on the "Budget as an instrument of efficiency". He has given us a vivid survey of the budgeting system in various countries.

He has specifically pointed out that there are some four stages or checks that are being exercised in different countries, namely, first, there is the screening of the demands at different levels. Then there is the execution stage where again checks can be exercised by the various authorities. Then we have the accounting stage, with which, of course, if it is absolutely up-to-date and regular so as to enable you to get the accounts in time, you can again exercise further checks. In fact in business management, as you know, it is these accounts that are presented to them regularly every month that enables the Board of Directors to keep track of the expenditure and have a control over the operations.

As for railway, I may say in this connection that, every item which is capable of being checked for productivity is invariably checked. But, as you know, in the case of railways, there are a number of items which are not capable of meticulous checking. For example, there is a whole lot of passenger amenities being provided. There you cannot really assess in monetary terms the value of each improvement. Those are

determined on the basis of social thinking and the sort of amenities we want in our country, and on that basis amenities are provided. Likewise in the case of staff amenities, they are not capable of evaluation in terms of money.

There are some other items also in the case of railways, like minor operational improvements. For example, you might put up an additional platform at a particular station. Now it is difficult to evaluate in terms of money as to what will be the exact benefit. But still, the advantages of putting up an additional platform at a station are determined and evaluated in a different way in order to satisfy ourselves that it is being done for production purposes.

But one thing which unfortunately is lacking not only in the case of railways but practically in our entire budgeting set-up, is that forward commitments arising out of the investments are never evaluated. Perhaps they may in certain cases be confined to the department's files, etc., where they may be assessing as to what will be the recurring revenue expenditure. It is done in the case of railways, for example, if you are doubling a railway track. They determine how many gangmen will be needed and so on.

But no department today can say that as a result of the past investments, say in the next year or in the next two or three years, what the increase will be in our recurring expenditure, which I think is very important. It would be worthwhile if we could evolve a system whereby every major investment is backed up by its recurring expenditure and that recurring expenditure is thrown forward and evaluated clearly; so that if at any time you were to review whether the commitments that you had already undertaken would over-burden you in future years with recurring expenditure, you could at least take a view. At the present time, for example, we just cannot do it. Some of the district boards, etc., are getting a lot of money and setting up a lot of hospitals, etc. Now those are leading to recurring expenditure and we do not know whether their revenues can stand the proper maintenance of those hospitals. Likewise the same thing arises in regard to roads. We are putting up so many roads all over: district board roads, state roads, central highways and so on. Unless there are funds available for their proper upkeep, there is no point in building.

Therefore, a forward assessment of the revenue expenditure arising out of the investments ought to be attempted.

In our case, as you know, there is not the possibility of making that meticulous check by the Parliament of the annual budget as is being done in some other countries. Practically from the time of presentation of the budget by the Finance Minister up to the time it is finally approved, it is about a month's time and during this one month's time it is physically impossible for the Parliament to go into very much detail in regard to the individual items of expenditure. But our system, as you know is slightly different. We have the Estimates Committee which reviews the past expenditure in considerable detail, and makes copious comments in regard to the various expenditures that have been incurred by the different ministries. These provide to us certain guidelines. Of course, the Government has to take them into account in framing their future budgets.

But the budget of a particular year is not subjected to that detailed scrutiny by the Parliament. On the other hand, our system is somewhat different from the system explained by Prof. Heckscher: in our case we have got what is known as the internal finance associated with every Ministry. They invariably go through every item. They are more or less part and parcel of the Ministry's organisation and everything passes through them. They have therefore an opportunity to scrutinise it and therefore every item of expenditure gets very careful analysis and study by the internal finance. Once it has passed the internal finance, the Finance Ministry still has the option to make a cut. Normally those cuts are based on general considerations and not on individual considerations.

In the case of certain departments like Railways or Posts and Telegraphs or Defence, where the expenditures are of a specialised character, the internal finance there is again specially trained for the purpose. They, in fact, live with them, they start their career with them, and they are built up in the whole set up of working. Therefore, they are fully familiar with the technicalities of the particular organisation which helps them in dealing with these problems.

Let me conclude. We have heard a most instructive and illuminating lecture from Prof. Heckscher and we are grateful and beholden to him.

*Dr. Khosla (Director, IIPA):* The Chairman has thanked His Excellency the Swedish Ambassador for his most illuminating and instructive lectures, and on behalf of the Institute I thank him also for the same. The lectures were not only illuminating and instructive, but they were given in a language which even a non-finance man can understand. That is because of his political science background !



## WORKING PAPER ON THE PRINCIPLES OF PERFORMANCE BUDGETING

By

Dr. M. J. K. Thavaraj

1. Performance Budgeting is generally understood as a system of presentation of public expenditure in terms of functions, programmes, performance units, *viz.*, activities/projects, etc., reflecting, primarily, the governmental output and its cost. In accordance with such a functional classification the term 'programme' related to a higher level of organisation embracing a number of performance units; though at times, in the budgetary parlance, the terms 'programme' and 'performance' budgeting have been used more or less interchangeably. The present system of classification is in terms of functions, missions, programmes and programme elements with a view to integrating planning and programming with budgeting.

2. The Programme Budgeting System tends to highlight the need for clearly defined objectives; choice between alternative programmes based on their cost-benefit implications; spelling out the future cost repercussions of near-term financial commitments etc. In essence, Programme Budgeting emphasises the need for overall programme management in the light of long-term objectives. The keynote of Performance Budgeting, on the other hand, has been on improvement of internal management on the basis of the volume of work to be accomplished (during a financial year) and its cost. Consequently, Performance Budgeting involves the development of more refined management tools such as work measurement, performance standards, unit costs, etc.

3. In a planned economy, it is logical to think in terms of budgeting both as the nearest link in a well-integrated system of planning, programming and budgeting and as a tool of management, providing a system of information for decision-making, coordination, evaluation and control to appropriate levels of the organisation.

4. Besides favouring a "rolling" plan (as against 'terminal' five or six-year plan) an integrated Programme Budget would demand a clearer expression of national and programmatic goals, formulation of alternative programmes with the delineation of their cost and output streams, choice of programmes as well as the determination of an order of priorities on the basis of their relative costs and benefits. These are indicative of the high degree of sophistication in the techniques and practices of planning and programming that needs to be attained in order to ensure rational utilisation of the national resources. Performance Budgeting could be the basis of such a super-structure.

5. The managerial potentialities of budgeting may be developed through: (a) the classification of public expenditure in terms of functions, sub-functions, programmes, sub-programmes, projects/activities, works/tasks; (b) the establishment, improvement and extension of activity schedules for all measurable activities of government; (c) the establishment of work output, employee utilisation standard, or unit costs, by objective methods; and (d) the creation of related cost and performance recording and reporting system.

6. Whereas the classification of operating expenditure is in terms of functions, programmes, activities and tasks, that of investment expenditure is in terms of functions, programmes, projects and works. The U.N. Manual for Programme and Performance Budgeting has defined these terms clearly. Functions represent broad groupings of operations that are directed towards accomplishing a major purpose of government. Programmes refer to broad categories within a function that identify end products of major organisations. In the operating categories, it constitutes an instrument for performing functions

by which goals could be set and realised by high-level administrative units. As an investment category, a programme constitutes an instrument for establishing targets to be achieved through an integrated set of investment projects. Complex programmes are divided into sub-programmes to facilitate executions in specific areas. An activity refers to a more limited division of action geared towards the attainment of the goals of an operating programme or sub-programme involving processes for which an intermediate or a lower-level administrative unit is responsible. An activity consists of several specific operations forming part of a process aimed at achieving a particular result. On the other hand, a project refers to a series of works in an investment programme or sub-programme for the formation of capital goods, which are carried out by a production unit capable of functioning independently. Works constitute a part of a stage in the formation of capital good that is a segment of a project. Thus, functional classification is the sheet anchor of Performance Budgets which aggregate budget data to show the share of public expenditure devoted to each public service.

7. Activity schedules are designed to highlight the major purposes to be served, the identification of programmes directed towards these ends, indication of projects/activities under each programme as well as the measurement of the volume of work with data on past, current and anticipated workload, such as the number of children to be educated, number of hospital beds to be provided, number of trees to be planted, tons of garbage to be collected etc. These measures should, as far as possible, be countable, reflective of the important resources used and should be set forth in functional terms. If the organisational structure corresponds to the functional framework of an agency or department, it will facilitate the decentralisation of programme and financial responsibility to suitable operational levels within the organisation.

8. Performance Budgeting cannot make much headway without proper measures of work. But there is no single yardstick for measuring activity or for determining performance standards. Some agencies can use workload and unit cost

data; others may use mere workload data or some descriptive material. Often 'unit cost' conjures up visions of tremendous accounting charts, elaborate distribution tables and scores of accounting personnel busily preoccupied with problems of allocating administrative and other overheads on a cost accounting basis. Though it may be desirable to move progressively in the direction of more accurately quantified work and cost data, less sophisticated measures suitable to lower stages of development and skilled manpower of the various agencies may be employed in the short run. Standards set should be based on a complete understanding of the nature of the work rather than on historical or comparative data. Imperfections on this score would call for flexible standards which may be improved upon over time.

9. Record-keeping along functional lines would help to bring out the variance between budgeted and actual costs, thereby enabling management to check on the work accomplished against work assigned. Some operational factors are likely to lie behind every variation. Wide variations in performance ratios may be indicative of improper personnel utilisation, improper work distribution, inadequate procedures, inadequate equipment operation, etc. Some of these may be remediable. Where the variation is due to remediable factors, timely and suitable actions may be taken to eliminate the gap. An ideal reporting system should cover the volume, quality, time expended and costs of each programme or activity. Accrual accounting may be used wherever appropriate.

10. It should be recognised that in some areas like diplomacy, work may not be measurable; certain others, like police or fire protection, may not lend themselves to refined measurements; some with large administrative overheads may present knotty problems of cost allocation; sometimes running accounts of work may not tie neatly with budgetary allotments. Nevertheless, a predominant segment of governmental operations can be reduced to sensible quantitative categories capable of measurement at varying degrees of refinement. Experience has shown that the advantages of pressing forward in the direction of quantifications and measurements are enormous.

Much, however, depends on whether the introduction of Performance Budgeting is a part of a major change in budgetary and administrative philosophy. Given the desire and drive for efficient management of governmental organisations, Performance Budgeting could serve as a convenient tool of management. It helps administrators to prepare their budgets on the basis of what they hope to accomplish; it serves both as a tool for reviewing the efficiency of existing operations and their results and as a system of feeding the data for planning future services; it upgrades the budget decision-making process by throwing up the requisite information on costs and work accomplishments appropriate for various levels of operation; it makes legislative review, control and policy-making more meaningful and makes budgets informative and understandable to the taxpayer. It should be an excellent instrument for translating long-term plans and programmes into reality. It is certainly not a panacea for administrative ills. But, in the hands of skilful administrators it should produce impressive results.

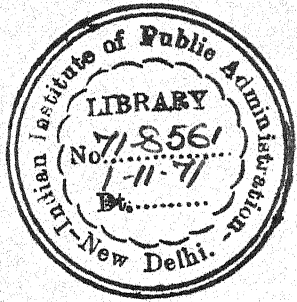
11. Within this broad framework of Performance Budgeting, the technique of 'cost-effectiveness' may gradually be introduced in quantifiable areas. This would facilitate a rational choice of programmes in terms of the relative cost and benefits streams of comparable alternatives designed to fulfil the same objectives. Such an improvement would help to integrate the processes of Planning, Programming and Budgeting.

12. India has a growing public sector with a large developmental component. It has practised *ex ante* quantification of her long-term objectives. It has had some experience in programming. But, budgets are not phrased in the same language of the plans. Despite the various reforms the classification of the budget still remains "eclectic". There is hardly any attempt at measurement or costing. There is an enormous criss-crossing of functional and organisational responsibilities. The "Demands" structure and account heads are somewhat archaic. Accounting is not yet an internal responsibility. Timely and adequate information is not made

available for review and corrective action. In essence, budget has not yet become a handy instrument for management. It has a long way to go towards the development of an integrated system of Planning, Programming and Budgeting. The introduction of Performance Budgeting is likely to be a step forward in overcoming some of these deficiencies.

13. There are certain steps that may be necessary for the installation of Performance Budgeting in India. Firstly, a constitutional amendment may be necessary to change the accounting format, "Demand" structure, and the role of the Office of the Comptroller and Auditor General of India, as well as to restructure the governmental organisation more or less on functional lines. Secondly, arrangements will have to be made to persuade all the state governments to accept the timetable for the transition to Performance Budgeting. Thirdly, a five-year plan for the adoption of Performance Budgeting by all the Departments of the central and state governments may be drafted. The new system may be introduced in two departments in the Centre and one or two departments in each of the State Governments. A progressive switch-over may be phased so that the budgets in all the departments of the central and state governments may be converted to a performance basis over a five-year period. Beginnings may also be made in the progressive metropolitan governments in developing performance budgets. A similar timetable may also be set for introducing accrual accounting in areas such as public works, railways, irrigation, defence, P & T, etc., where it is likely to be most effective. Initial efforts in this direction may be spent in identifying areas where accrual accounting is more essential. A switch-over to this system should be preceded by adequate preparation, especially with a view to reorient the accounting facilities with the new concepts, procedures and purposes. Fourthly, the Indian Institute of Public Administration with the help and support of the Department of Administrative Reforms, Planning Commission, the Ministry of Finance, the Auditor and Comptroller General's office and corresponding agencies in the state governments, may spearhead the movement towards Performance Budgeting. It is but natural that every human being resists changes, particularly those which may

upset the fundamental aspects of his daily work. Adequate preparation to improve human acceptance is, therefore, necessary to smooth the transformation process. Apart from neat and comprehensive manuals of instruction, group meetings, discussions, conferences, seminars, short courses, etc., may have to be organised covering a fair percentage of the personnel involved in the affected agencies. The IIPA may play the coordinating role in this important area.





for instance, for old-age pensions. You cannot possibly find any system whereby you do not have to see at least how much is going to be spent on these pensions. On the other hand, there are a number of services which are used, and must be used for very different purposes. Now you cannot possibly budget for each particular objective separately because the service in question will deal with all of them.

I will give you an instance which is very relevant to my present occupation—the cost of an Embassy. You cannot possibly split up the cost of an Embassy ascertaining that so much is spent for providing passports and so much on public relations, so much is to be spent on reporting and so on and so forth. It is necessary in that case to have what I am calling subjective budgeting. But even so, the emphasis may be more on one or more on the other.

The term 'performance budgeting' in this terminology is used for something which goes even further than what I here call objective budgeting. That is the type of budgeting where the appropriations, or rather the sums available to the Ministry or agency are more or less directly related to the services rendered, so that with an increase in services, there will be a more or less automatic increase in the money provided for those services. Performance budgeting is usually used in the case of public enterprises, because there, quite obviously there is an input-output relation, and at least to some extent the amount of funds available to the agency, or to the enterprise, is related to the business activities of that enterprise. In some cases, the public enterprise is run almost on a commercial basis : the public enterprise pays its way and a little more. There will be very few limitations actually on its expenditure as long as it is run at a profit. The limitations there will be chiefly related to major investments for the future which have to be financed out of borrowing, or which for other reasons, for instance of cyclical policy, have to be limited at a given time and increased on other occasions. But on the whole, the tendency in all the countries which I have studied is for public enterprises to work on what I would call the basis of performance budgeting.

Apart from that, in most countries, subjective budgeting is the normal procedure. They budget for the services, for the

types of expenditure without much relation to the particular objectives. This is so on the whole in the U.K. It is very definitely so in France. I should say France has subjective budgeting with a vengeance, even more than any other country I know of. I should say that probably my own country, Sweden, comes second. There also, subjective budgeting dominates to a very considerable extent and it is actually, in most cases, very difficult to see from the budget what is spent on a given type of expenditure. This has caused considerable concern, and experiments are now taking place with objective or even performance budgeting, in selected parts of the administration.

Now, if you are to move from subjective budgeting into objective budgeting, it means that you would leave the spending agency, whether it be a Ministry or an agency, freedom of choice between different means to be employed to gain a given objective. You may say, for instance, that such an amount is set aside for a certain objective. Whether they spend it all on personnel, all on equipment, or part on personnel and part on equipment, is their choice and will depend on the circumstances. In a country such as my own, where there is shortage of manpower, shortage of personnel, with a comparatively good supply of foreign exchange, it would probably in many cases be economical to reduce personnel by introducing labour-saving equipment, even if that equipment is to be imported. On the other hand, in a country where there is a shortage of foreign exchange and a good supply of personnel and manpower, you would go the other way. You would refrain from using labour-saving equipment, you would still employ procedures which require a considerable amount of manpower and a considerable amount of personnel, so as to avoid the difficulty of importing labour-saving equipment.

But there is not only a permanent difference between different types of environment, in which case our problems would be fairly easy to solve. There may in many cases be a choice to be taken at a given moment. For instance, in a certain office you may have the possibility of having two more stenographers or a dictaphone. If you have a dictaphone, you can use typists with far less training and the initial investment and the comparatively small current expense for that purpose would, therefore, simplify matters. You may be able to decide

on this at the moment when you find that the skilled stenographers are not available: that is to say you do not have to decide it in advance when the budget is established. You decide it at the point where the need arises and you find that the means you previously employed are not sufficient to gain your purpose. Objective budgeting leaves the spending agencies this freedom of choice. Therefore it makes their work more flexible and in many cases I would say, also more efficient.

Now there are countries which to some extent—I do not think completely, because it cannot be done completely—have introduced this system. The United States, and in particular I would say the States rather than the Federal Government, and even more the cities, which have often a different type of administration, have gone a long way towards introducing objective budgeting. In the Federal Government it is more difficult, partly because the Federal Government deals with things where objective budgeting is often much more difficult, *e.g.*, the foreign service and defence. I think it is true to say that in the United States there is a very strong general trend towards objective budgeting, and this is to some extent influenced by the fact that in the United States private enterprise is almost invariably held up as a model to the public services, and in private enterprise objective budgeting is the rule. Of course, they are not bound by the need to have a budget to be approved by Parliament or Government authorities. They can make whatever changes they like in the current year. The shareholders' meeting does not decide on the budget for a private enterprise. And because this is so, and because the traditions of private enterprises are so strong in the United States, they have at this point been able to influence, first municipal government, then State Government and to some extent even Federal Government.

But there is a European country which has also gone a long way towards objective budgeting, and which, in fact, has introduced something which involves even performance budgeting, and that is the Netherlands. In the Netherlands, budget reform has been going on for a long time after the war. The traditions of objective budgeting and performance budgeting were established chiefly during the seven year period of Prof. Pieter Liefstinck as Finance Minister of Holland. He

eventually moved to the World Bank and then to the International Monetary Fund. But when the Dutch were setting up their administration after the war, they could begin more or less with a clean slate and Prof. Lieftinck, who did not come from the public services but from academic life, with some experience of business, consciously introduced a system of this type. Of course, even there elements of subjective budgeting remain to some extent.

But when I say that they even have a system of performance budgeting in some cases, I am thinking of the control exercised by the Finance Ministry. In fact, in Holland when an appropriation has been passed by Parliament, that does not mean that it is necessarily available to the services in question. It still requires specific permission from the Finance Ministry to release the credit in question, and the Finance Ministry is free to refuse it on different grounds. It even happens, and this I think is a characteristic which exists nowhere else, that the Finance Ministry will refuse to release funds for a given purpose because the appropriation is too small. They will say that the appropriation is insufficient to achieve the objective and therefore rather than use some money without achieving the purpose they will release no money at all. This means, in actual fact, of course, that they put themselves up as judges even above Parliament and say that Parliament has made a mistake in granting too small an appropriation for the objective in question.

I do not say that this happens very often, because obviously the knowledge that the Finance Ministry has this power and may use it in certain circumstances would influence the same Finance Ministry when it is making up the budget. So when they plan the budget and when they approve the appropriations at the initial stage, at the stage of establishing the budget, they will take specific care not to put themselves in the position where, later on, they may have to refuse to release the appropriation which they approved originally. But it means of course, also, that Parliament has to be very careful in reducing appropriations, and, in fact, I think the main outcome of this—I rather believe that this was to some extent Pieter Lieftinck's idea—has been to increase enormously the power of the Finance Ministry. The Finance



Ministry comes in at both ends; both in the establishment of the budget and in the substantive control over execution, and this means that they exercise even more power than Finance Ministries in other countries; and this is saying quite a lot because Finance Ministries are, of course, very powerful all over the world.

Now, I have gone into this at some length, because I feel that this tendency which we find in the United States on the basis of the idea of private enterprise, but which we also find in a country like Holland on quite different grounds, is probably something which will be under discussion for a long time, and which is likely to influence budgeting all over the world, in particular when the scale of activities of the State is growing and those parts of public activities which are of a more or less economic character take on larger importance; because then the result will be that the model of private enterprise will have to be used to an increasing extent even by public agencies.

Now you may understand from what I have been saying that I regard this development on the whole as very beneficial. I think that in the circumstances of the modern State, it is quite definitely an improvement that we get more of objective budgeting and even an element of performance budgeting to a greater extent than before.

But I would not be quite honest if I were not also to point out that there are rather serious difficulties inherent in this system, and these difficulties are to some extent, at least I think to a major extent, related to the questions of accounting, audit and all sorts of controls. Objective budgeting is possible, and even natural in a comparatively small organisation where the leadership can exercise far-going control over the whole of its own administration. It is also something which would be ideal provided human nature were such as to make no controls necessary, provided you could assume that administrators are all-wise and always completely selfless. In these circumstances objective budgeting would be the ideal. On the other hand, it is quite clear that in the real circumstances of the world, and human nature being what it is, we must look at the other side. Objective budgeting, of course, is in some respects advantageous even from the point of view

of post-audit or current control through accounting and current audit. To the extent that control is related to efficiency, this type of budgeting facilitates it. I would even say that as long as it is related to real economy in administration, the input-output relations, the relationship between the funds made available and the extent to which objectives are gained, that relation is more obvious, and therefore also it is easier afterwards to check whether this has been achieved. But you will remember that we talked about other aspects also of auditing, such as checking of the honesty and the reliability of the administration and the legality of expenditures; and that obviously becomes more difficult in a system of objective budgeting. If the administrator wants to cheat, wants to be dishonest, it is much easier if his budget is based on the achievement of a given objective without specification of the means which he has to employ. It would then be rather difficult to find out if the means he has been employing are dishonest, as long as he has achieved the object reasonably well. And that is all that would appear from a study of the input-output relations, and if he wants to employ means or practices which are not acceptable, then even a rather careful audit might not find him out.

I shall stop here for a moment and go over to the second problem which is related to that of objective and subjective budgeting and where the character of the problem is much the same. And that is the question of details in budgeting. To what extent does the budget go into the details, small figures even, in regard to appropriations and allocations for given purposes? Now in many countries, and again both France and Sweden are typical, the budget is split up into a great number of items, some of which are comparatively very small. I once made a study of the Swedish budget in that respect, and I came to a total figure of about 1,500 items in the budget of the Swedish Government, and going further I found that nine out of these 1,500 items were responsible for two-thirds of the expenditure; the remaining 1,491 items were responsible for only one-third. This detailed budgeting is something which you find in countries like France and Sweden and in a great number of other countries as well—I do not know what the situation is in India, but I know that in another developing

country, which I once studied, viz., Turkey, budgeting was more or less on the same lines as in France in this respect. This system has historical explanations. It also has political explanations, because it means that the budgeting authority, and traditionally this used to be Parliament, can exercise much political influence over the administration by deciding that so much money is to be used for this little item and so much money for the other, thereby binding the administration in its activities to follow along the lines where Parliament wants it to go.

On the other hand, of course, the system has very great disadvantages. The budget is normally made up, or at least begins to be made up, anything from half a year to one year before execution even commences, which means that it will be approximately one year behind your forecasts. Many things happen during one year of administration, and quite frequently you will find that these small items are unrealistic. You may find that due to unforeseen circumstances you provided too much money for one purpose, too little money for another purpose, and the administration will find itself bound by these appropriations and allocations, and its activities will be correspondingly hampered. It also sometimes leads to rather undesirable practices, for instance, the practice of spending whatever is left over in a given item just before the end of the budget year. It is a practice which I think we all know because it happens in all administrations where subjective budgeting is employed, and the cause of it is that if, when the budget is established next time (or rather the time after next because there is a time-lag in between), the Ministry or agency in question has not spent its appropriations, the Ministry of Finance will be inclined to reduce them, whereas, perhaps, the situation was that they had too little need of one detail that year, while in the subsequent year there may be more of it. This does not appear because in any case they were not allowed to spend more than was provided for, and in order to avoid difficulties of this type, they will spend, not according to their needs, but according to their forecast of the effect of spending on future budgeting. This, obviously, is far from satisfactory. You will also find that sometimes, because of this detailed budgeting, an agency, even a rather small agency,

will be rather haphazard in its spending. They will spend money simply where it so happens that they have been provided with reasonably good funds.

I was once Chairman of the board of an approved school, where certain sums were needed for food, certain sums for clothing and so forth. The sums for clothing were insufficient and the sums for food were too high. So the children in the approved school at the end of the budget year got sumptuous meals, but it was very difficult to provide them with decent clothes when they were discharged. Now, the answer to this obviously is either to do away with detailed budgeting and provide a lump sum, or else to find some means whereby transfers can take place. In the French system and also in many other systems, in fact, there is provision for something which is called 'virement', that is transfer of sums from one item to another. Normally the spending agency is not permitted to do this entirely on its own. They will require permission from some superior agency, sometimes even from the Finance Ministry. But they will not normally require parliamentary approval: which means that in the course of executing the budget, if you find you have provided too much at one point and too little at another point for the same general purpose, you will be permitted to transfer money from the item which is too high to the item which is too low. Actually this means introducing by the back door something which is rather like objective budgeting. You still split up your items according to the subjective system, but you provide the means whereby a certain amount of objectivity can be introduced in the execution.

There is another device which comes at an earlier stage, and which I think can be combined with performance budgeting. That is what we have been calling in our political discussions in Sweden—it has not been employed to any major extent but it has in some cases—framework budgeting. It means that Parliament and the Finance Ministry after hearing the demands of the spending ministries will allocate to each of them, a lump sum and so you make up your budget on the assumption that the total of your budget is such an amount. The spending ministry will then do the same thing to its subordinate agencies. They will say, "Well, this is what we have



got from the Finance Ministry. We have to divide it up. Now we feel that for this particular section of our work we cannot provide any more than that. But we leave it to you. You have more experience than the central officials of the Ministry to say how you are going to divide this up between the different items in your budget." Admittedly, this does not permit changes of scale during the period of execution of the budget. But on the other hand, it does at least give the substantive authorities more influence over the actual spending than they have under the old system.

We have employed this in some cases, for instance, in the case of some semi-public institutions which draw most of their funds from the Government, but technically and constitutionally are not part of the administration. They will be given a lump sum and freedom to use it according to the budget they have established for themselves.

We have been also using it to a considerable extent in defence, and here I think I should like to make a brief excursion and tell you how our system has been working in this field. Of course, the defence budget today of any country is a very considerable part of the whole. The problem confronting it originally was a political problem, to prevent questions on military expenditure and defence from becoming too important in party conflicts. In order to avoid that, one Royal Commission after another was set up to study defence. These Royal Commissions included parliamentarians from all political parties and worked on the basis of proposing a framework for the total cost of defence per year. Normally, these reports and the decisions subsequently taken unanimously, or more or less unanimously by Parliament, covered more than one year. Agreement was made on defence expenditure for two, three or even four years, and the decisions were for a lump sum for defence as a whole. It was then left to the military authorities between them to split this up, or rather it is for the Ministry of Defence to divide up the lump sum among different forces, and then the Chief of the Army and the Chief of the Navy and the Chief of the Air Force themselves will bring forward proposals to the Defence Ministry for spending within this sum. Actually we found that this system worked very well. Parliamentarians are not military experts. It is,

therefore, not very easy for them to take the detailed substantive decisions necessary in the highly technical field of modern defence. On the other hand, I think it was Lloyd George who once said that defence is far too important to be left to Generals. And for this reason you cannot possibly let the military decide how much money they are going to spend on defence. We found that framework budgeting made it possible to combine in a rather satisfactory way the technical knowledge of the military personnel and the political sagacity of parliamentarians from different parties. We were on the whole rather happy with this system.

To sum up: in using the word "efficiency" it is necessary always to remember that the word is closely related to the word "effect". Efficiency means finding the best means to achieve a given objective, a given effect. It means that in administration emphasis has to be put on the objectives of administrative functions rather than on the niceties of procedure. It has to be brought in from the pure economic field into the field of administration. Even when productivity cannot be measured in figures, and this is very often the case in public administration, the very idea that administration should be productive of a given effect has considerable influence on the working of modern public administration, and it has to be brought in at least to the same extent in budgetary structures and procedures.

Related to this is the problem of decentralisation. The growing administrative structure—and all modern countries have an administrative structure which is growing—will be increasingly dependent on decentralisation and delegation, otherwise it will become unbearably slow and cumbersome to the public. Decentralisation cannot stop short of budgeting. Decentralisation must also mean that you decentralise financial decisions to a considerable extent. Moreover it is necessary to get rid of some of the fictions connected with budgeting. I referred in my earlier lecture to one of these, namely, the question of the financial year or the budget year, which is quite obviously nothing more than an auxiliary device—just as a five year plan is, of course, an auxiliary device; it does not mean that you will achieve miracles exactly in five years, nor will you achieve miracles exactly in one year. Your miracles, if you

achieve them, may take three years four months and twenty-five days just as often as any other fixed period of time. On the other hand, budgeting will, of course, have to be based on some time schedule. What is necessary is to see that these auxiliary devices, such as financial years and five year plans, do not achieve a life of their own. We have in some cases a device—I think it is used in many countries, although I have chiefly seen it in my own, and there again I would refer to the experiences of our defence budget—what is called “a rolling budget”. You make up your planned expenditure, let us say, for 4 to 7 years, or whatever it is, but you change it every year. That is, every year you make up a new plan. If I were to transfer this to the idea of your five year plans, it would mean that you introduce in 1966 the five year plan for the period 1966-71. You then introduce in 1967 another five year plan for the period 1967-72, taking into account the experience you gained in the first year. Then in 1968, you get a plan for 1968-73 and so on and so forth. You will not be bound by the period of five years. You will be able to make the necessary changes as you go. But at the same time, you will be able to plan fairly long in advance. To some extent, I should say this procedure can be used also with regard to the normal budget and annual budgeting. You can make up a budget which in form is for one year, but which actually is a rolling plan for, let us say, three years or four or five, taking into account the possible forecasts for the period after the budget year. And, of course, if you have to use the devices which we have been talking about before, you may also be able to make changes in the course of the budget year.

This means of course that in the whole field you have to introduce procedures which are more flexible than the traditional ones. It must then be remembered that these less rigid procedures demand a high degree of honesty and devotion to duty on the part of the administrative personnel. But they require even more. They require not only that honesty and devotion are actually present, but also that the public is confident of their existence. As long as the public, rightly or wrongly, is suspicious of administrative agencies and their personnel, they will not be prepared to accept these more flexible procedures. That is, I think one of the crucial

problems. Because as long as procedures are inflexible it is unlikely that confidence will be forthcoming. On the other hand, if confidence is not forthcoming, it is difficult to get rid of these inflexible procedures. This is the type of difficulty with which we are always confronted in public administration. The fact that our administration has been going on for such a long time with a modicum of success seems to indicate that this type of problem can somehow be solved, and I think it can be solved in budgeting as well as in other fields.

### Questions and Answers

*Q. No. 1 :* You were talking of police and the armed services. What is the test? More arrests made or less arrests made? The answer I think lies not in the arrests made or arrests not made. It is the social order which is wanting to be on-going. The test would be: does it promote an on-going social order? Does it promote harmony? Investment on police will not be on what the police has done by their own function but something outside, in the social function which they promote.

There is something like deceptive budgets like the type of budgets which Hitler made in which heavy expenditures could be hidden. My question is this: How on earth do the other related facts get hidden?

How could a small country like Poland manage to have 500 aircraft? Secondly, how could this country afford to spend so much on defence without the risk of breakdown in social order?

*Answer :* The harmony of the social order can usually not be measured in figures, and budgeting is concerned with figures and that is the reason why it is so difficult to find a measure. You will remember that yesterday Dr. Thavaraj used the words 'measure for the productivity'. You may say that a given system of policing is on the whole efficient or inefficient. But to measure in figures let us say, the increase of efficiency which you may gain by certain additional appropriations for a certain purpose is practically impossible. You will have to rely more or less on arbitrary judgment in order to assess the



relations between input and output in an administrative situation like that.

With regard to your other question, that is on deceptive budgets, Hitler could present deceptive budgets because he was safe from opposition. In a democratic system, particularly in a system of parliamentary government it is the business of the opposition to investigate carefully and put its finger on anything which is deceptive. If the opposition fulfils that function, which I should say it does normally in countries like U.K., Sweden and France, the Government will not even attempt to present a deceptive budget because if they do they run the very serious danger of being kicked out. Therefore, the very existence of a watchful opposition has considerable effect on the working of the Government. It is necessary, of course, for this purpose that the opposition should do a lot of thankless spade work. And actually you will find that sometimes the work of the opposition in this respect is more helpful to the Government than to the opposition parties themselves because they will not gain very much from it in elections. But they will, on the other hand, perform a useful function for Government.

You asked how the Poles could provide for 500 aircraft secretly. That is related to your third question: How are we to build up a defence system in any country, India or any other, when the expenses run so high that they may upset the whole of the social order? Again that is a question where you may say that you will have to run risks on both counts. You will have to provide a defence system which is perhaps not enough to get you full security. But, on the other hand, you will also have to build up a defence system which costs so much that it precludes you from doing what you would like to do in other fields, such as education, social security, etc. It is a question of rather hard-headed decisions; and not merely that, but also courageous decisions about priorities, rather than falling back on wishful thinking, either of the type that you think you can achieve complete military security or that you can feel so secure that you do not have to spend anything at all on defence.

We have had this problem for a long time in Sweden. I think the question of our defence expenditure in fact was our major political question from about 1910 until about 1940,

that is until the beginning of the second world war. We thrashed it out over and over again. We quite often found the results very unsatisfactory on both scores. But in the end, by trial and error, and because we were lucky and avoided having to put our defences to actual use, we have now achieved what we think is a reasonable balance. The balance, of course, will be different from country to country. It depends on the political and strategic situation. It depends also on its economic potentials. There is a mean which can be struck, but of course it is not always a popular decision to take either way.

*Q. No. 2 :* Many years ago Mr. Bevan suggested that a normal budget should be prepared for two years instead of one year to make proper utilization of the funds.

You have also mentioned about honesty and devotion. I have seen that in spite of the huge volume of rules and regulations to check dishonesty in spending of funds, we have not succeeded altogether.

One main drawback is this, that we attach too much importance for minor things. We think Rs. 2 is the same as Rs. 20 lakhs, Rs. 50 lakhs or Rs. 2 crore.

*Answer :* With regard to the annual budgets, I mentioned in my earlier talk that in the Netherlands there is a constitutional provision which makes it possible to have biennial budgets. It is the only country I know which has such a provision. The point is that it has never been applied. I think the reasons for this are political rather than economic. It is simply that parliament will not be satisfied if such a long period has to lapse between the decision taken and the actual execution, but it can be done in many ways. I think in many countries, there is a tendency today to emphasise, not financially, but in the discussion, certain parts of the budget in one year and others in the next year. The whole thing will work much like what I have been calling a rolling biennial budget: that is the decisions will be taken I think for two, three or four years rather than one but it will not be taken for the whole budget at once. You will go into different parts at different times.

Your second question about regulation and dishonesty is perfectly valid. A great number of regulations do not provide for more honesty and quite often the effect is to the contrary. If you regulate too much you open avenues of dishonesty which should not exist otherwise. But I was discussing this from a very specific point of view, that is of objective or subjective budgeting. And there I would still say that objective budgeting does provide more opportunities for dishonesty than subjective budgeting, whereas on the other hand a great number of details introduced into the budget do not necessarily provide for greater honesty.

Finally, you said that, related to this problem also, there was a tendency to put too much importance on minor things. Yes. This is a very curious thing. I noticed it in a fairly long political life both on a municipal body where I once sat and also in Parliament. Members are much more interested in discussing the small sums than in the large ones, and I have been asking myself: why is that so? I think the psychological explanation is really rather easy. A sum of Rs. 10,000 is intelligible to every one. We all have some experience of what it means. A sum of Rs. 10 crores is completely unintelligible to most people. They just do not know what it is. They have never seen it and they have never dealt with it in their private affairs and therefore they actually fight shy of discussing problems of this type which lie entirely outside their personal experience. It is, if you like, one of the shortcomings of democracy, except that you will remember that in a dictatorship probably the same thing would apply to the people actually in power. You do not have a philosopher king governing in a dictatorship today, and even if you had a philosopher king, he would be unlikely to be a budget philosopher. So normally you will find that this is a difficulty which arises in all systems of modern government. We are dealing in Government, and budgeting in particular, with figures which are to use a hackneyed term astronomical, even to the extent that to most of us they seem to be in the stars rather than on this earth and therefore we are unable to understand what they actually mean.

*Q. No. 3:* In India planning is centralised, plan

exercises are spread over a number of years. In the case of the rolling plans much attention would be diverted from execution to plan formulation and there will be paid more attention in plan formulation rather than in plan implementation.

Secondly, you have been pointing out the desirability of decentralisation and delegation. Every one shares the desire; but centralisation asserts itself, because in the complexities of modern management of large-scale enterprises, or activities on a large scale, there is not the same flow of competence to the lower levels as there are at the higher levels. Therefore even though you decentralise on paper, there is a tendency for re-centralisation in practice. So, is there any system by which we could decentralise competence along with our plans for decentralisation of functions ?

*Answer :* I think both of your questions are very relevant. But on the first one, I am afraid, I do not agree with you. The situation is, I believe, quite the contrary. I would say that a rolling plan would have to take much more account of implementation than a plan which is for a fixed period of time. If you make up a fixed five year plan, then after the plan is made up, there is no current checking on implementation or at least there does not have to be. When you then come to the end of the five year period, you may be able to say—"Well, we fell short on so and so much on this point and so and so much at that point. We are very sorry. But now we are making a new plan for another five years and we are going to make good all that we fell short of last time and do a lot besides." And you present that with great hopes and then you leave it for another five years and at the end of those five years, you may have to say more or less the same thing—"We failed at certain points but we are not going to fail the next time", which may or may not be true. Whereas, if you have a rolling plan, the idea is that you will always have to present the extent of implementation which has taken place, and therefore you will keep tabs on implementation the whole time.

Let us say that you are including in the plan two steel

plants, and you are expecting to add two more steel plants later on. This means you begin with the first two steel plants in 1966 and you expect to begin with the next two in 1970. By 1967 you can probably not say very much about the first two. By 1968 they should be well under way, and in making up the five year plan from 1968-73, you will already have to say quite a lot about the two new steel plants, and in drawing up your plans there you will have to refer to the experiences you actually gained in planning the two first. Thus, in a rolling plan, I would say, the relationship between planning and implementation is clearer than it is if you make up fixed long-term plans.

The second question is of course a very serious one. It is quite obvious that decentralisation becomes a mere sham unless people at the lower levels are able to accept responsibility. I realise that this is a very serious problem in many countries and probably not least in India. It is quite clearly a difficulty. On the other hand, I would say also that as long as you do not decentralise and delegate authority, you will never have good people at lower levels. The effect of decentralisation on personnel policies will show up: you will have fewer attractive posts at the top, at the centres, and more attractive posts at the lower levels. You will decentralise authority. But authority always attracts competent people. You can not make competent people accept a post which does not carry authority. Therefore, as long as your administrative system is centralised, you will risk finding indifferent people at the lower levels. Decentralisation has a different effect. I think we have seen this in Western Europe and also in the United States, perhaps particularly in the United States, where the more modern systems of City Government and State Government have attracted administrators who are at least quite as competent as those who are available to the Federal Government, because they carry authority. A person who can be a State Governor may even prefer that to being Attorney-General of the United States. He may feel that the post of the State Governor is more important, gives him more authority than that of Attorney-General at the Centre; and he will find that the post of Attorney-General in a state is more attractive than the post of Assistant Attorney-General to the Federal Government and so forth. Even when you



have a Federal system, which incidentally of course you have here, the same thing would apply. We have in my country a system of administration which is rather similar to what you find on the European continent in general. Provincial governors are appointed by the Central Government. The recruitment to these posts, which are purely administrative, is extremely satisfactory. Former Cabinet Ministers, former Secretaries, leading politicians, even from private enterprises, will very gladly accept appointment as provincial governors because they know these posts carry a considerable amount of authority—territorially limited to a province, but within that province wide and important. I would say therefore that to some extent at least decentralisation attracts competent personnel to the lower levels.

*Q. No. 4 :* To what extent would you advocate a fully divided budget only in the non-investment sector of the Government ?

*Answer :* As a matter of fact I am not altogether happy about a divided budget at all, because I think the distinction between capital budget and current budget, or investment budget and current budget, is one of the artificialities of our budget system, and for two reasons. In the first place, very often it is difficult to say whether a given expenditure is for investment or for current expenses. Small investments, such as buying typewriters, will always come on to the current budget but are nonetheless in actual fact investments. The typewriter is not worn out in one year, at least not if the typist is reasonably competent. Therefore, it is actually an investment which should carry over a number of years. Still, it can never appear in the investment or the capital budget. Moreover, there may be a choice (as I tried to point out before) between investment and current expenses. You may sometimes try to achieve a given objective by deciding either on investing this year, let us say, Rs. 10 lakhs, or spending, let us say, Rs. 2 lakhs for each of the next five years. And one comes on the capital budget and the other comes on the current budget—but actually the choice is an administrative and not really a financial choice. So I should say that a totally divided budget will always be something of a fiction. What you need is to decide to what extent you are going

to finance your budget by borrowing. And then you come out of the realm of administration into the realm of economics. Because there is not only a question of financing certain types of expenditure by borrowing and other types of expenditure by tax revenue, it is also a question of the cyclical situation or cyclical policy. You may say at a given time it may be necessary to finance even long-term investments out of tax revenue because it is necessary to prevent overheating in economic life. At other times it is necessary to stimulate economic life and then you have to borrow more. Thus you have the old Keynesian theory, to the extent it is applicable, coming in at this point. And if you have a completely divided budget, you will still have to finance some of your investments out of revenues in certain years. In other years you will perhaps finance some of your current expenditure out of loans, and the whole distinction becomes, as I said before, more a fiction than a reality.

*Chairman* : Well, friends, we have heard two very interesting lectures from Prof. Heckscher on the "Budget as an instrument of efficiency". He has given us a vivid survey of the budgeting system in various countries.

He has specifically pointed out that there are some four stages or checks that are being exercised in different countries, namely, first, there is the screening of the demands at different levels. Then there is the execution stage where again checks can be exercised by the various authorities. Then we have the accounting stage, with which, of course, if it is absolutely up-to-date and regular so as to enable you to get the accounts in time, you can again exercise further checks. In fact in business management, as you know, it is these accounts that are presented to them regularly every month that enables the Board of Directors to keep track of the expenditure and have a control over the operations.

As for railway, I may say in this connection that, every item which is capable of being checked for productivity is invariably checked. But, as you know, in the case of railways, there are a number of items which are not capable of meticulous checking. For example, there is a whole lot of passenger amenities being provided. There you cannot really assess in monetary terms the value of each improvement. Those are

determined on the basis of social thinking and the sort of amenities we want in our country, and on that basis amenities are provided. Likewise in the case of staff amenities, they are not capable of evaluation in terms of money.

There are some other items also in the case of railways, like minor operational improvements. For example, you might put up an additional platform at a particular station. Now it is difficult to evaluate in terms of money as to what will be the exact benefit. But still, the advantages of putting up an additional platform at a station are determined and evaluated in a different way in order to satisfy ourselves that it is being done for production purposes.

But one thing which unfortunately is lacking not only in the case of railways but practically in our entire budgeting set-up, is that forward commitments arising out of the investments are never evaluated. Perhaps they may in certain cases be confined to the department's files, etc., where they may be assessing as to what will be the recurring revenue expenditure. It is done in the case of railways, for example, if you are doubling a railway track. They determine how many gangmen will be needed and so on.

But no department today can say that as a result of the past investments, say in the next year or in the next two or three years, what the increase will be in our recurring expenditure, which I think is very important. It would be worthwhile if we could evolve a system whereby every major investment is backed up by its recurring expenditure and that recurring expenditure is thrown forward and evaluated clearly; so that if at any time you were to review whether the commitments that you had already undertaken would over-burden you in future years with recurring expenditure, you could at least take a view. At the present time, for example, we just cannot do it. Some of the district boards, etc., are getting a lot of money and setting up a lot of hospitals, etc. Now those are leading to recurring expenditure and we do not know whether their revenues can stand the proper maintenance of those hospitals. Likewise the same thing arises in regard to roads. We are putting up so many roads all over: district board roads, state roads, central highways and so on. Unless there are funds available for their proper upkeep, there is no point in building.

Therefore, a forward assessment of the revenue expenditure arising out of the investments ought to be attempted.

In our case, as you know, there is not the possibility of making that meticulous check by the Parliament of the annual budget as is being done in some other countries. Practically from the time of presentation of the budget by the Finance Minister up to the time it is finally approved, it is about a month's time and during this one month's time it is physically impossible for the Parliament to go into very much detail in regard to the individual items of expenditure. But our system, as you know is slightly different. We have the Estimates Committee which reviews the past expenditure in considerable detail, and makes copious comments in regard to the various expenditures that have been incurred by the different ministries. These provide to us certain guidelines. Of course, the Government has to take them into account in framing their future budgets.

But the budget of a particular year is not subjected to that detailed scrutiny by the Parliament. On the other hand, our system is somewhat different from the system explained by Prof. Heckscher: in our case we have got what is known as the internal finance associated with every Ministry. They invariably go through every item. They are more or less part and parcel of the Ministry's organisation and everything passes through them. They have therefore an opportunity to scrutinise it and therefore every item of expenditure gets very careful analysis and study by the internal finance. Once it has passed the internal finance, the Finance Ministry still has the option to make a cut. Normally those cuts are based on general considerations and not on individual considerations.

In the case of certain departments like Railways or Posts and Telegraphs or Defence, where the expenditures are of a specialised character, the internal finance there is again specially trained for the purpose. They, in fact, live with them, they start their career with them, and they are built up in the whole set up of working. Therefore, they are fully familiar with the technicalities of the particular organisation which helps them in dealing with these problems.

Let me conclude. We have heard a most instructive and illuminating lecture from Prof. Heckscher and we are grateful and beholden to him.

*Dr. Khosla (Director, IIPA):* The Chairman has thanked His Excellency the Swedish Ambassador for his most illuminating and instructive lectures, and on behalf of the Institute I thank him also for the same. The lectures were not only illuminating and instructive, but they were given in a language which even a non-finance man can understand. That is because of his political science background !



## WORKING PAPER ON THE PRINCIPLES OF PERFORMANCE BUDGETING

*By*

**Dr. M. J. K. Thavaraj**

1. Performance Budgeting is generally understood as a system of presentation of public expenditure in terms of functions, programmes, performance units, *viz.*, activities/projects, etc., reflecting, primarily, the governmental output and its cost. In accordance with such a functional classification the term 'programme' related to a higher level of organisation embracing a number of performance units; though at times, in the budgetary parlance, the terms 'programme' and 'performance' budgeting have been used more or less interchangeably. The present system of classification is in terms of functions, missions, programmes and programme elements with a view to integrating planning and programming with budgeting.

2. The Programme Budgeting System tends to highlight the need for clearly defined objectives; choice between alternative programmes based on their cost-benefit implications; spelling out the future cost repercussions of near-term financial commitments etc. In essence, Programme Budgeting emphasises the need for overall programme management in the light of long-term objectives. The keynote of Performance Budgeting, on the other hand, has been on improvement of internal management on the basis of the volume of work to be accomplished (during a financial year) and its cost. Consequently, Performance Budgeting involves the development of more refined management tools such as work measurement, performance standards, unit costs, etc.

3. In a planned economy, it is logical to think in terms of budgeting both as the nearest link in a well-integrated system of planning, programming and budgeting and as a tool of management, providing a system of information for decision-making, coordination, evaluation and control to appropriate levels of the organisation.

4. Besides favouring a 'rolling' plan (as against 'terminal' five or six-year plan) an integrated Programme Budget would demand a clearer expression of national and programmatic goals, formulation of alternative programmes with the delineation of their cost and output streams, choice of programmes as well as the determination of an order of priorities on the basis of their relative costs and benefits. These are indicative of the high degree of sophistication in the techniques and practices of planning and programming that needs to be attained in order to ensure rational utilisation of the national resources. Performance Budgeting could be the basis of such a super-structure.

5. The managerial potentialities of budgeting may be developed through: (a) the classification of public expenditure in terms of functions, sub-functions, programmes, sub-programmes, projects/activities, works/tasks; (b) the establishment, improvement and extension of activity schedules for all measurable activities of government; (c) the establishment of work output, employee utilisation standard, or unit costs, by objective methods; and (d) the creation of related cost and performance recording and reporting system.

6. Whereas the classification of operating expenditure is in terms of functions, programmes, activities and tasks, that of investment expenditure is in terms of functions, programmes, projects and works. The U.N. Manual for Programme and Performance Budgeting has defined these terms clearly. Functions represent broad groupings of operations that are directed towards accomplishing a major purpose of government. Programmes refer to broad categories within a function that identify end products of major organisations. In the operating categories, it constitutes an instrument for performing functions

by which goals could be set and realised by high-level administrative units. As an investment category, a programme constitutes an instrument for establishing targets to be achieved through an integrated set of investment projects. Complex programmes are divided into sub-programmes to facilitate executions in specific areas. An activity refers to a more limited division of action geared towards the attainment of the goals of an operating programme or sub-programme involving processes for which an intermediate or a lower-level administrative unit is responsible. An activity consists of several specific operations forming part of a process aimed at achieving a particular result. On the other hand, a project refers to a series of works in an investment programme or sub-programme for the formation of capital goods, which are carried out by a production unit capable of functioning independently. Works constitute a part of a stage in the formation of capital good that is a segment of a project. Thus, functional classification is the sheet anchor of Performance Budgets which aggregate budget data to show the share of public expenditure devoted to each public service.

7. Activity schedules are designed to highlight the major purposes to be served, the identification of programmes directed towards these ends, indication of projects/activities under each programme as well as the measurement of the volume of work with data on past, current and anticipated workload, such as the number of children to be educated number of hospital beds to be provided, number of trees to be planted, tons of garbage to be collected etc. These measures should, as far as possible, be countable, reflective of the important resources used and should be set forth in functional terms. If the organisational structure corresponds to the functional framework of an agency or department, it will facilitate the decentralisation of programme and financial responsibility to suitable operational levels within the organisation.

8. Performance Budgeting cannot make much headway without proper measures of work. But there is no single yardstick for measuring activity or for determining performance standards. Some agencies can use workload and unit cost

data; others may use mere workload data or some descriptive material. Often 'unit cost' conjures up visions of tremendous accounting charts, elaborate distribution tables and scores of accounting personnel busily preoccupied with problems of allocating administrative and other overheads on a cost accounting basis. Though it may be desirable to move progressively in the direction of more accurately quantified work and cost data, less sophisticated measures suitable to lower stages of development and skilled manpower of the various agencies may be employed in the short run. Standards set should be based on a complete understanding of the nature of the work rather than on historical or comparative data. Imperfections on this score would call for flexible standards which may be improved upon over time.

9. Record-keeping along functional lines would help to bring out the variance between budgeted and actual costs, thereby enabling management to check on the work accomplished against work assigned. Some operational factors are likely to lie behind every variation. Wide variations in performance ratios may be indicative of improper personnel utilisation, improper work distribution, inadequate procedures, inadequate equipment operation, etc. Some of these may be remediable. Where the variation is due to remediable factors, timely and suitable actions may be taken to eliminate the gap. An ideal reporting system should cover the volume, quality, time expended and costs of each programme or activity. Accrual accounting may be used wherever appropriate.

10. It should be recognised that in some areas like diplomacy, work may not be measurable; certain others, like police or fire protection, may not lend themselves to refined measurements; some with large administrative overheads may present knotty problems of cost allocation; sometimes running accounts of work may not tie neatly with budgetary allotments. Nevertheless, a predominant segment of governmental operations can be reduced to sensible quantitative categories capable of measurement at varying degrees of refinement. Experience has shown that the advantages of pressing forward in the direction of quantifications and measurements are enormous.

Much, however, depends on whether the introduction of Performance Budgeting is a part of a major change in budgetary and administrative philosophy. Given the desire and drive for efficient management of governmental organisations, Performance Budgeting could serve as a convenient tool of management. It helps administrators to prepare their budgets on the basis of what they hope to accomplish ; it serves both as a tool for reviewing the efficiency of existing operations and their results and as a system of feeding the data for planning future services; it upgrades the budget decision-making process by throwing up the requisite information on costs and work accomplishments appropriate for various levels of operation; it makes legislative review, control and policy-making more meaningful and makes budgets informative and understandable to the taxpayer. It should be an excellent instrument for translating long-term plans and programmes into reality. It is certainly not a panacea for administrative ills. But, in the hands of skilful administrators it should produce impressive results.

11. Within this broad framework of Performance Budgeting, the technique of 'cost-effectiveness' may gradually be introduced in quantifiable areas. This would facilitate a rational choice of programmes in terms of the relative cost and benefits streams of comparable alternatives designed to fulfil the same objectives. Such an improvement would help to integrate the processes of Planning, Programming and Budgeting.

12. India has a growing public sector with a large developmental component. It has practised *ex ante* quantification of her long-term objectives. It has had some experience in programming. But, budgets are not phrased in the same language of the plans. Despite the various reforms the classification of the budget still remains "eclectic". There is hardly any attempt at measurement or costing. There is an enormous criss-crossing of functional and organisational responsibilities. The "Demands" structure and account heads are somewhat archaic. Accounting is not yet an internal responsibility. Timely and adequate information is not made



available for review and corrective action. In essence, budget has not yet become a handy instrument for management. It has a long way to go towards the development of an integrated system of Planning, Programming and Budgeting. The introduction of Performance Budgeting is likely to be a step forward in overcoming some of these deficiencies.

13. There are certain steps that may be necessary for the installation of Performance Budgeting in India. Firstly, a constitutional amendment may be necessary to change the accounting format, "Demand" structure, and the role of the Office of the Comptroller and Auditor General of India, as well as to restructure the governmental organisation more or less on functional lines. Secondly, arrangements will have to be made to persuade all the state governments to accept the timetable for the transition to Performance Budgeting. Thirdly, a five-year plan for the adoption of Performance Budgeting by all the Departments of the central and state governments may be drafted. The new system may be introduced in two departments in the Centre and one or two departments in each of the State Governments. A progressive switch-over may be phased so that the budgets in all the departments of the central and state governments may be converted to a performance basis over a five-year period. Beginnings may also be made in the progressive metropolitan governments in developing performance budgets. A similar timetable may also be set for introducing accrual accounting in areas such as public works, railways, irrigation, defence, P & T, etc., where it is likely to be most effective. Initial efforts in this direction may be spent in identifying areas where accrual accounting is more essential. A switch-over to this system should be preceded by adequate preparation, especially with a view to reorient the accounting facilities with the new concepts, procedures and purposes. Fourthly, the Indian Institute of Public Administration with the help and support of the Department of Administrative Reforms, Planning Commission, the Ministry of Finance, the Auditor and Comptroller General's office and corresponding agencies in the state governments, may spearhead the movement towards Performance Budgeting. It is but natural that every human being resists changes, particularly those which may

upset the fundamental aspects of his daily work. Adequate preparation to improve human acceptance is, therefore, necessary to smooth the transformation process. Apart from neat and comprehensive manuals of instruction, group meetings, discussions, conferences, seminars, short courses, etc., may have to be organised covering a fair percentage of the personnel involved in the affected agencies. The IIPA may play the coordinating role in this important area.

